

No. 10806

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United States  
Circuit Court of Appeals

For the Ninth Circuit. *Vol*

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*2392*

BARNHART-MORROW CONSOLIDATED, a  
corporation,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

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Transcript of the Record

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Upon Petition to Review a Decision of the Tax Court  
of the United States

FILED

AUG 31 1944

PAUL P. O'BRIEN,  
CLERK



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Circuit Court of Appeals  
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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

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## APPEARANCES:

For Taxpayer:

GEO. F. MEITNER, C. P. A.

HAROLD C. MORTON, ESQ.,

B. W. BURKHEAD, ESQ., A. S. F.

For Commissioner:

E. A. TONJES, ESQ.,

R. C. WHITLEY, ESQ.

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Docket No. 185859

BARNHART-MORROW CONSOLIDATED,  
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

## DOCKET ENTRIES

1940

Dec. 13—Petition received and filed. Taxpayer notified. Fee paid.

Dec. 13—Copy of petition served on General Counsel.

Dec. 13—Request for Circuit hearing in Los Angeles, Calif. filed by taxpayer. 12-13-40  
Copy served.

1941

Jan. 29—Answer filed by General Counsel.

Jan. 31—Notice issued placing proceeding on Los Angeles, Calif. calendar. Service of answer and request made.

1941

July 15—Hearing set Sept. 22, 1941 in Los Angeles, California.

Oct. 4—Hearing had before Mr. Disney on the merits. Submitted. (Stipulation as to facts filed.) Appearance of B. W. Burkhead filed. Briefs due from petitioner 11-25-41. Respondent 12-24-41. Reply briefs 1-10-42.

Oct. 21—Transcript of hearing 10-4-41 filed.

Nov. 24—Brief filed by taxpayer. 11-24-41 Copy served on General Counsel.

Dec. 24—Motion for extension to Jan. 24, 1942 to file reply brief filed by General Counsel. 12-26-41 Granted.

1942

Jan. 9—Motion for extension to Feb. 16, 1942 to file reply brief filed by taxpayer. 1-9-42 Granted.

Jan. 13—Reply brief filed by General Counsel. Served 1-13-42.

Feb. 16—Reply brief filed by taxpayer. 2-16-42 Copy served on General Counsel.

Aug. 20—Findings of fact and opinion rendered, Disney, Judge, Div. 4. Decision will be entered under Rule 50. 8-26-42 Copy served.

Sept. 17—Motion for reconsideration of decision or rehearing and for additional findings filed by taxpayer.

1942

Dec. 4—Order that to the extent that the motion relates to a rehearing and to reconsider the issues on loss deduction for well No. 16 and insolvency be denied, and (a) certain figures be inserted in lieu of figures appearing on pages 7, 8, 14 and 17 of the printed opinion and (b) the findings of fact be amended and further order that allowances for depletion in the taxable years be recomputed under Rule 50 in accordance with the findings of fact of this Court, as amended and supplemented by this order entered. [1\*]

1943

Feb. 10—Computation of deficiency filed by General Counsel.

Feb. 10—Motion for leave to file attached amendment to answer asking for increased deficiency, amendment to answer asking for increased deficiency lodged, filed by General Counsel. 3-9-43 Granted.

Mar. 9—Hearing set March 31, 1943 on settlement.

Mar. 26—Computation of deficiency filed by taxpayer.

Mar. 26—Motion for continuance to 5-3-43 filed by taxpayer. 3-29-43 Granted to 5-5-43.

Mar. 29—Copy of computation served on General Counsel.

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\*Page numbering appearing at top of page of original certified Transcript of Record.



1943

May 5—Hearing had before Judge Disney on settlement under Rule 50. Held C. A. V. Respondent's memorandum filed. (Copy served on petitioner at hearing). Briefs due, none.

May 8—Transcript of hearing 5-5-43 filed.

July 30—Order that paragraph (b) of order of 12-4-42 be modified and further ordered that parties submit recomputations under Rule 50 in accordance with the findings of fact as amended and supplemented by this order entered.

Nov. 18—Revised computation of deficiency filed by General Counsel.

Nov. 24—Hearing set Dec. 22, 1943 on settlement.

Dec. 20—Motion for continuance to Jan. 3, 1944 filed by taxpayer. 12-21-43 Granted to 1-5-44.

1944

Jan. 1—Recomputation filed by taxpayer. 1-3-44 Copy served.

Jan. 5—Hearing had before Judge Disney on settlement. Uncontested.

Jan. 7—Memorandum in support of Rule 50 re-computation filed by taxpayer.

Jan. 24—Decision entered, Disney, Judge, Div. 4.

Feb. 17—Motion for rehearing and vacating decision Jan. 24, 1944 filed by taxpayer.

Feb. 29—Order that petitioner's motion of 2-17-44 is denied entered.



1944

May 15—Petition for review by U. S. Circuit Court of Appeals, 9th Circuit, with assignments of error filed by taxpayer.

May 16—Proof of service filed by taxpayer.

May 16—Designation of portions of record filed by taxpayer with proof of service thereon.

May 16—Statement of points filed by taxpayer.

[2]

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United States Board of Tax Appeals

Docket No. 105859

BARNHART-MORROW CONSOLIDATED,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION

The above named Petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his Notice of Deficiency (IT:LA:PB-90D) dated September 18, 1940, and as a basis of its proceedings alleges as follows:

1. The Petitioner is a corporation organized under the laws of the State of California under date of December 24, 1926 with its principal office at Suite 1020 Subway Terminal Building, 417 South Hill Street, Los Angeles, California. The returns

for the calendar years 1936 and 1937 here involved were filed with the Collector of Internal Revenue for the 6th District of California.

2. The Notice of Deficiency (a copy of which is attached and marked Exhibit "A") was mailed to the Petitioner on September 18th, 1940.

3. The taxes in controversy are income taxes for the calendar year 1936 consisting of normal tax approximating \$9,161.06 and surtax on undistributed profits of \$18,342.69 or a total of \$27,503.75 for the year 1936, and income taxes for the calendar year 1937 consisting of normal tax of \$6,321.00 and surtax on undistributed profits of \$9,495.89 or a total of \$15,816.89 for the year 1937. [3]

4. The determination of the income taxes set forth in the said Notice of Deficiency is based upon the following errors:

(a) The Respondent erred in determining what constitutes the gross income of the Petitioner, for the year 1936, from the sale of oil and gas produced, and as respects each of Petitioner's oil wells.

(b) The Respondent erred in determining what constitutes the net income of the Petitioner, for the year 1936, from the sale of oil and gas produced, and as respects each of Petitioner's oil wells.

(c) The Respondent, in erroneously determining what constitutes the gross income and what constitutes the net income of the Petitioner, for the year 1936, from the sale of oil and gas produced, and as respects each of Petitioner's oil wells; erred in determining the amount of depletion allowable for the

year 1936, and as respects each of Petitioner's oil wells.

(d) The Respondent erred in including as income for the year 1936, the sum of \$7,000.00 salary accrued in 1931, in dispute and cancelled on Petitioner's books in 1936.

(e) The Respondent erred in disallowing as a bad debt deduction for the year 1936, the sum of \$16,500.10.

(f) The Respondent erred in disallowing as a loss deduction for the year 1936, the worthlessness of the fractional interest of the Petitioner in a Patent.

(g) The Respondent erred in disallowing as a deduction from income for the year 1936, receivership expenses in the sum of \$11,908.53.

(h) The Respondent erred in failing to determine that the Petitioner was insolvent during the period of receivership in the year 1936 and accordingly erred in determining that the Petitioner was subject to a surtax on undistributed profits for the year 1936 under the provisions of Section 14 of the Revenue Act of 1936. [4]

(i) The Respondent erred in determining what constitutes the gross income of the Petitioner for the year 1937, from the sale of oil and gas produced, and as respects each of Petitioner's oil wells.

(j) The Respondent erred in determining what constitutes the net income of the Petitioner for the year 1937, from the sale of oil and gas produced, and as respects each of Petitioner's oil wells.

(k) The Respondent, in erroneously determining what constitutes the gross income and what constitutes the net income of the Petitioner, for the year 1937, from the sale of oil and gas produced, and as respects each of Petitioner's oil wells; erred in determining the amount of depletion allowable for the year 1937, and as respects each of Petitioner's oil wells.

(l) The Respondent erred in disallowing depletion in the amount of \$3,857.29 claimed by the Petitioner for the year 1937 on the income received by the Petitioner in the year 1937 on the Participating Oil Agreement Interests held in Julian Wells Nos. 1, 2 and 3.

(m) The Respondent erred in disallowing as a loss deduction the sum of \$43,151.96 sustained by the Petitioner in the year 1937, on the quitclaiming and relinquishment of Petitioner's interest in Julian Well No. 16.

(n) The Respondent erred in disallowing as a deduction from income for the year 1937, interest accrued in the amount of \$300.17 on the liability of Federal Income and State Franchise Taxes of the Petitioner payable on the net income for the year 1936.

(o) The Respondent erred in disallowing as a deduction from income for the year 1937, capital stock taxes accrued as of December 31, 1937 in the additional sum of \$441.00.

(p) The Respondent erred in disallowing as a business expense legal fees paid in the additional sum of \$250.00. [5]

5. The facts upon which the Petitioner relies as a basis of this proceeding are as follows:

(1) (a) Barnhart-Morrow Consolidated, a corporation, was organized under the laws of the State of California under date of December 24, 1926 for the purpose of acquiring all of the assets of Bar-Mor Petroleum Corporation, and Barnhart-Morrow and Company, Incorporated, both California corporations, and other producing and non producing oil properties.

(b) The said Barnhart-Morrow Consolidated keeps its books and records on the accrual basis and its income tax returns for the years 1936 and 1937 as well as for all years prior thereto have been filed on the accrual basis in reporting net taxable income.

(c) Among the assets acquired by said Barnhart-Morrow Consolidated from its immediate two predecessor companies was an "Operating Agreement" dated January 15, 1925, wherein C. C. Julian, acting for and in behalf of himself individually and as agent for the holders of Participating Oil Agreements and holders of Per Cent Interstate, executed and delivered to, with and in favor of W. J. Barnhart and D. R. Morrow, the said Operating Agreement. The assignment of said Operating Agreement, to said Barnhart-Morrow Consolidated was consented to by said C. C. Julian. Said Operating Agreement embraces and covers the mineral properties known as the Brunson Lease and upon which premises were drilled Julian Wells Nos. 1, 2, 3, 4, 5, 11 and 12. On August 24, 1929, for a valuable consideration, said C. C. Julian, acting for and in



behalf of himself individually and as agent for the holders of Participating Oil Agreements and holders of Per Cent Interests in said wells, made, executed and delivered to, with and in favor of Barnhart-Morrow Consolidated an amendment thereto, by the terms of which the said Barnhart-Morrow Consolidated became entitled to an additional 15% of the proceeds of the sale of oil from said oil wells, making a total of 65% of the proceeds of oil and 50% of the gross proceeds from gas [6] after deducting landowners' royalties, and oil and gas consumed in the operation of said wells.

(2) (a) On or about March 9, 1928 United Oil Well Supply Company, a corporation, of Los Angeles, California, Wm. B. Himrod, and W. W. Hyams, owners of fee title to the property hereinbelow described, together with Lem A. Brunson and Clara Brunson, his wife, as lessors, executed and entered into an oil and gas lease with W. J. Barnhart, as lessee, which lease was recorded August 6, 1928 in Book 7274, Page 1 of Official Records of Los Angeles, County, California. Said lease, for convenience, is hereinafter referred to as the United Lease, and covers the following described property:

The North Half of the North Half of the Northeast quarter of the Southwest quarter of Section Six, Township Three South, Range Eleven West, S. B. B. & M. in the County of Los Angeles, State of California.

Excepting therefrom such portions thereof as are specifically set out in said lease.

(b) Said United Lease is subject to all of the rights of C. C. Julian under and pursuant to a certain lease dated June 2, 1922 by and between Globe Petroleum Corporation, a corporation, as lessor, and C. C. Julian as Lessee, and likewise subject to all of the rights of C. C. Julian under and pursuant to a certain lease dated March 26, 1923 by and between Globe Petroleum Corporation, a corporation, as lessor, and C. C. Julian, as lessee, and of all renewals and ratifications thereof.

(c) That the terms of the said United Lease provide for the payment of 16-2/3% landowners' royalty of all oil, gas and other hydro-carbon substances produced and saved from any wells drilled to a depth in excess of 6000 feet, unless oil is found in commercial paying quantities below the Meyer sand, and at a depth not to exceed 6000 feet; and further that in the event the lessee drills a well on said premises to the Meyer sand or to a sand at a lesser depth [7] than the Meyer sand, then and in that event the landowners' royalty shall be 20% of all oil, gas and other hydro-carbon substances produced and saved from the wells and the lessees interest in the production from said wells shall then be 80%.

(3) (a) After the execution of said United Lease, and on or about September 28, 1928, said W. J. Barnhart, jointly with his wife, Elsie D. Barnhart, assigned said United Lease to C. C. Julian, insofar as the same related to the

Westerly 543 feet of the premises covered

thereby, excepting therefrom a portion of the said Westerly 543 feet described as follows:

Commencing at the Northwest corner of said Westerly 543 feet, thence South 150 feet on a line parallel with the Westerly boundary of said property; thence West 200 feet parallel with the Northerly line of said property to a point; thence North 150 feet to the Northerly line of said property; thence East 200 feet to the place of beginning.

(b) Said assignment was recorded in Book 7437, Page 290 of Official Records of Los Angeles County, California. Following the execution of said assignment of said Westerly 543 feet of the United Lease to said Julian, said Julian commenced the drilling of Well No. 17, which well is located in the Southeast 100 feet of the West 543 feet of the premises described in said United Lease.

(c) After C. C. Julian had commenced the drilling of Well No. 17, the said C. C. Julian on October 24, 1928, joined therein by his wife, Mary Julian, made, executed and delivered a written assignment to A. L. Jameson, of the said United Lease insofar as it applied to that portion of the property upon which said Well No. 17 was being drilled, such portion being more particularly described as follows:

That portion of the West 543 feet of the North Half of the North Half of the Northeast Quarter of the Southwest Quarter of Section 6, in Township 3 South, Range 11 West, S. B. B. & M., in Los Angeles County, California, described as follows: [8]



Commencing at a point in the Southerly line thereof, 543 feet distant from the Southwest corner of said property; thence North 121 feet on a line parallel with the Westerly boundary line of said property to a point; thence West 250 feet and parallel with the Southerly line of said property to a point; thence South 121 feet on a line parallel with the Westerly boundary line of said property to a point on the Southerly boundary line of said property, thence East 250 feet along the Southerly boundary line of said property to the place of beginning, containing 69/100 acres, more or less.

(d) On the same date, to-wit: October 24, 1928, said C. C. Julian and A. L. Jameson entered into an Operating Agreement with respect to Well No. 17 and the premises upon which the same is located, and so assigned by said Julian to the said Jameson, wherein it was provided that said Jameson should carry on the drilling of Well No. 17, and after payment of the lessors royalty of  $1/6$  under the terms of the United Lease, the said Jameson should receive from 83-1/3% of the production of the said well the sum of \$100,000.00, and thereafter all proceeds of production should be divided equally between said Jameson and said Julian. Said Jameson, thereafter, to-wit: on October 31, 1928, duly assigned to the Santa Fe Springs Oil Company, a corporation, all rights, so acquired by him with respect to said Well No. 17.

(e) Said Santa Fe Springs Oil Company drilled

said Well No. 17 to a depth in excess of 7000 feet or thereabouts, but did not produce from that depth. Thereafter, and on or about July 9, 1930, the said Santa Fe Springs Oil Company entered into an agreement with W. J. Barnhart, whereby said Barnhart agreed to develop said Well No. 17 upon production in the Meyer sand, and in consideration thereof, after payment of the royalty of  $1/6$  under the terms of the United Lease, the remaining  $83-1/3\%$  of the proceeds of production should be distributed equally to the Santa Fe Springs Oil Company and said Barnhart until such proceeds aggregated \$78,000.00 and thereafter such proceeds should be distributed  $3-2/3\%$  to the Santa Fe Springs Oil Company,  $38\%$  to said Barnhart, and  $41-2/3\%$  to C. C. Julian, as provided in said operating agreement between [9] Julian and Jameson. Thereafter, and on July 30, 1930, said W. J. Barnhart duly assigned all rights so acquired by the Santa Fe Springs Oil Company with respect to Well No. 17 to Barnhart-Morrow Consolidated, and Barnhart-Morrow Consolidated ever since has been and now is the owner of all rights conferred upon said Barnhart by said agreement of July 9, 1930 between the Santa Fe Springs Oil Company and W. J. Barnhart. That thereafter said Barnhart-Morrow Consolidated worked upon said Well No. 17 and placed the same upon production in the said Meyer sand.

(f) On or about December 5, 1928, C. C. Julian assigned, transferred and set over to one Wm. M. Cady,  $30\%$  of the residue of the proceeds of sale or other disposal of the net production from said Well

No. 17. That said Cady on or about July 10, 1929 assigned 10% out of such 30% to A. L. Jameson.

(g) That on or about December 1, 1931 the said Cady assigned 20% of such 30% assigned to Cady by said Julian to J. A. Smith.

(4) (a) On or about September 28, 1928, said W. J. Barnhart, joined by his wife, Elsie D. Barnhart, assigned to Barnhart-Morrow Consolidated that portion of the United Lease excepted and reserved as set forth in paragraph (3) (a) above in assignment made to C. C. Julian, and under which assignment there was reserved to W. J. Barnhart a one-half interest in the well to be drilled on the premises so excepted and reserved.

(b) That on the same day, to-wit: On September 28, 1928, said W. J. Barnhart, and Barnhart-Morrow Consolidated entered into an Operating Agreement in respect to Well No. 16 and the premises upon which the same is located and so assigned by said Barnhart to the said Barnhart-Morrow Consolidated wherein it was provided that said Barnhart-Morrow Consolidated agrees to immediately drill a well thereon to productive deep sands underlying said property and below 5000 feet depth. The said Operating Agreement by its terms provided for the payment of  $1/6$  royalty of all oil, gas, and other hydro-carbon substances [10] produced and saved from the well to the owners of the property as provided in said United Lease, and that said Barnhart-Morrow Consolidated shall be entitled to take and receive for its own use and benefit out of the  $83\frac{1}{3}\%$  of the oil, gas and other hydro-carbon substances

produced and saved from said Well, \$100,000.00 as its cost for drilling such well. That after said Barnhart-Morrow Consolidated shall have received the said sum of \$100,000.00 out of the first 83-1/3% of production, that thereafter the 83-1/3% of production shall be divided equally between the said Barnhart and Barnhart-Morrow Consolidated provided that the said Barnhart-Morrow Consolidated shall first be entitled to deduct from said 83-1/3% of the production from said well its necessary operating expenses which in no event shall exceed a sum which would amount to \$250.00 per month, when said well is flowing, nor more than \$500.00 per month when said well is pumping.

(c) On or about September 28, 1928, said W. J. Barnhart, joined by his wife, Elsie D. Barnhart, assigned to one Wm. M. Cady all of the right, title and interest of the said Barnhart so reserved in assignment made by the said Barnhart to Barnhart-Morrow Consolidated. The reservation of said one-half interest in Well No. 16 by W. J. Barnhart and the assignment thereof by him to said Cady were done for the use and benefit of C. C. Julian, said assignment from Barnhart to Cady being for a consideration paid by said Cady to said Julian.

(d) On or about September 28, 1928, said W. J. Barnhart and C. C. Julian entered into a purported Option Agreement with Barnhart-Morrow Consolidated, wherein it was provided that in the event said Barnhart-Morrow Consolidated shall elect not to drill said well to productive sands underlying said property below 5000 feet in depth, but to stop the

drilling [11] of said well in the Meyer sand and produce therefrom, that the said Barnhart-Morrow Consolidated shall pay the said Julian the sum of \$2,500.00 and further that the said sum of \$100,000.00 to be retained by the said Barnhart-Morrow Consolidated out of the first 83-1/3% of the production as its cost for the drilling of such well shall be reduced to the sum of \$80,000.00

(e) That after the assignment of the leasehold premises and the execution of the operating agreement on September 28, 1928, between W. J. Barnhart and Barnhart-Morrow Consolidated, the said Barnhart-Morrow Consolidated commenced the drilling of an oil well on said premises known as Well No. 16, and did drill the same to the Meyer sand. Said oil well was completed and came on production on or about February 29, 1929.

(f) On or about July 25, 1929, said Wm. M. Cady assigned all of his right, title and interest in and to Well No. 16 to one James B. Boyle, but that said assignment to Boyle by Cady was in the way of collateral security only.

(g) On or about May 15, 1930, said C. C. Julian advised said Barnhart-Morrow Consolidated that he had theretofore assigned to H. B. Flesher all of his right, title and interest in and to the proceeds from Well No. 16 due and payable to him under the terms of the Operating Agreement under which said Barnhart-Morrow Consolidated drilled and was operating said Well, and that any payments so made to said Flesher and his receipt therefor shall consti-



tute a full and complete release of any interest said C. C. Julian had in such proceeds.

(h) On July 18, 1930 said Barnhart-Morrow Consoildated advised said C. C. Julian that on August 20, 1929 it had received a notice from one James B. Boyle in which said Boyle advised said Barnhart-Morrow Consolidated that he had succeeded to all of the rights of C. C. Julian and Mr. Cady by [12] assignment of that agreement made between W. J. Barnhart and Elsie D. Barnhart and Barnhart-Morrow Consolidated, which was an Operating Agreement to provide for the operation of Well No. 16.

(i) On July 25, 1930 the said C. C. Julian, through his attorney in fact, H. B. Flesher, advised said Barnhart-Morrow Consolidated that the said James B. Boyle had no interest in and to that certain assignment given by C. C. Julian to Wm. M. Cady in and to Well No. 16 except insofar as concerned oil produced from a depth in excess of 5000 feet; and, further agreed therein, to protect and indemnify the said Barnhart-Morrow Consolidated against any and all action or actions that might be brought against said Barnhart-Morrow Consolidated by reason of their paying to said C. C. Julian or to his properly authorized agent such sums of money to which said C. C. Julian was entitled in accordance with existing agreements.

(j) That during the year 1930 there was paid to H. B. Flesher, in accordance with instructions given by said C. C. Julian in his authorization under date of May 15, 1930, the sum of \$16,500.10, which

was on account of a total of \$17,983.47 payable out of production from said Well No. 16 in 1930 in excess of \$80,000.00 well costs retained by said Barnhart-Morrow Consolidated out of the first 80% of production from said well.

(k) That at the final adjudication of the matter of Julian vs. Schwartz in October 1936, it was determined by the company that the \$16,500.10 paid by it to H. B. Flesher for the account of C. C. Julian had been paid in error since it was determined by the Court in that cause of action that Wm. Cady had succeeded to all of the rights, title and interest of C. C. Julian in that well and that J. A. Smith had acquired by purchase such interest from said Cady. That said Barnhart-Morrow Consolidated paid to J. A. Smith the sum of \$16,500.10 which it had theretofore paid to H. B. Flesher for the account of C. C. Julian and that the amount so paid to J. A. Smith was chargeable [13] to C. C. Julian in accordance with the indemnification letter which said Barnhart-Morrow Consolidated had received from said Julian on July 25, 1930. That the said C. C. Julian left the United States some time in the fore part of the year 1933 and that the said C. C. Julian died on or about March 25, 1934. That the company could not collect this sum from said C. C. Julian was definitely known at the time said amount was paid to J. A. Smith, and accordingly the amount of \$16,500.10 was charged off as a loss sustained by the company in the year 1936 when it was paid and in which year it was definitely determined who was entitled to receive such money.

(1) That on or about December 1, 1931 Wm. M. Cady sold, transferred, and assigned all of his rights in and to Well No. 16 to J. A. Smith and that said assignment was consented to by James B. Boyle.

(m) That on or about March 1, 1937 Barnhart-Morrow Consolidated experienced considerable difficulty in producing Well No. 16, said well being off production from March 7, 1937 to May 7, 1937, due to a collapse of the tubing in said well. Said well again went off production on May 20, 1937 to June 4, 1937 and again from June 6, 1937 to June 11, 1937.

(n) That the said Well No. 16 again went off production on or about December 16, 1937 and pursuant to a Resolution passed by the Board of Directors of said Barnhart-Morrow Consolidated on December 17, 1937, the interest of the said Barnhart-Morrow Consolidated in Well No. 16 was abandoned and quitclaimed to J. A. Smith, who had acquired by purchase and succeeded to all of the rights, title and interest of W. J. Barnhart, the original lessee under the United Lease and from whom said Barnhart-Morrow Consolidated had acquired its interest. That because of said abandonment and quitclaiming in Well No. 16, said Barnhart-Morrow Consolidated sustained a loss in the amount of \$43,151.96. [14]

(5) (a) That in addition to the operations by the Taxpayer of Julian Wells Nos. 1, 2, 3, 11, 16 and 17 located in the Santa Fe Springs Oil District in Los Angeles County, of the State of California, Taxpayer operated oil wells in Kern County, California known as K. C. L. Well No. 1, K. C. L. Well No. 2, K. C. L. Well No. 3, and K. C. L. Well No. 4.



(6) (a) On or about July 8, 1929 judgment was rendered for \$10,925.98 against C. C. Julian in an action of Garliepp and Mack vs. C. C. Julian, Superior Court Case No. 273-608. That thereafter and on or about December 9, 1929, the Sheriff of Los Angeles County, acting under a Writ of Execution issued in said action, pretended to sell to one R. L. Mack all of the right, title and interest of the said C. C. Julian, as an individual, in and to that property described in the Sheriff's Certificate of Sale on Execution, which involved the property on which Julian Wells Nos. 1, 2, 3, 11, 16 and 17 were drilled and other property in which taxpayer herein had no interest.

(b) That on or about December 11, 1930, a Sheriff's Deed to said property was executed and delivered by the Sheriff of Los Angeles County to said R. L. Mack who subsequently sold and assigned all of the right, title and interest so acquired under said Sheriff's Certificate of Sale on Execution and Sheriff's Deed to one W. A. Schwartz. That thereafter the said Schwartz served written notices on Barnhart-Morrow Consolidated, Walter J. Barnhart, Citizens National Trust and Savings Bank, et al; that he, said Schwartz, is entitled to the immediate possession of the real property upon which said oil wells above described have been drilled, and to the oil wells drilled thereon, and to the oil produced and to be produced therefrom, and asserted that he, the said Schwartz, intends to and will take over the possession of the said wells and the production therefrom

and intends to maintain and operate the said wells as his own property. [15]

(7) (a) That thereafter and on or about January 27, 1931, C. C. Julian, as plaintiff, filed an action against W. A. Schwartz, et al., in the Superior Court in the State of California, in and for the County of Los Angeles, Superior Court Case No. 315-345. The said C. C. Julian filed such action as a trustee of an express trust for the benefit of certain beneficiaries under the Declarations of Trust with the Citizens National Trust and Savings Bank of California. That the said action so filed was for the purpose of forever quieting the adverse claim of said W. A. Schwartz, defendant in said suit, in and to the mineral rights of the leasehold properties on which were drilled Julian Wells Nos. 1, 2, 3, 11, 12, 16, 17 and other wells in which taxpayer herein had no interest. That on or about March 16, 1931, said W. A. Schwartz, defendant in the matter of Julian vs. Schwartz, above mentioned, filed his answer in said cause of action, and that on or about the same day the said Schwartz filed his Cross-Complaint in said action, wherein the said Schwartz requested the appointment of a receiver; that an accounting be had of all sums received by Julian, Barnhart and Barnhart-Morrow Consolidated and that all interests of the parties be fixed and determined.

(b) That on or about March 19, 1931, Chas. F. Allison was appointed receiver and took possession of the properties and operated the same. That on or about March 25, 1932, the said Allison was re-

moved as receiver and C. L. Olson and J. A. Smith were subsequently appointed successors as co-trustees to take possession of the oil properties and operate the same during pendency of said cause of action. That all of the net proceeds from operation were impounded pursuant to the order of the Court by the said Allison and said Olson and Smith for the period March 19, 1931 to and including November 14, 1936, on which date the said oil properties [16] involving Julian Wells Nos. 1, 2, 3, 11, 16 and 17 were returned to the possession of Barnhart-Morrow Consolidated.

(c) That after the filing of said Cross-Complaint by said W. A. Schwartz the said C. C. Julian failed to answer the same and that Barnhart-Morrow Consolidated and other Cross-Defendants named in said amended cross-complaint of said Schwartz were obliged to file an answer to said cross complaint.

(d) That the Court in its Findings of Fact in the matter of Julian vs. Schwartz found that said Action and Judgment in said cause of action of Garliepp, et al., vs. Julian, case No. 273-608 involved and arose out of an account between the plaintiffs therein and said C. C. Julian, that said action and judgment had no relation and was not in any manner connected with any of the oil wells or the premises involved in said matter of said Julian vs. Schwartz, and further found that the said C. C. Julian had no interest in the premises described in said Brunson Lease and said United Lease at the time of the levy of the Execution in said case of Garliepp vs. Mack and at the time of the said Ex-

ecution Sale; and, that pursuant to judgment rendered in the matter of Julian vs. Schwartz the said Cross-Complainant, said W. A. Schwartz take nothing by his Cross-Complaint except such rights as he acquired by purchase since the commencement of said action, as declared and established in paragraph 14 of said judgment.

(e) That pursuant to said Judgment in said matter of Julian vs. Schwartz rendered under date of September 7, 1933, affirmed by the District Court of Appeal of the State of California, 1st Appellate District, Division 1, on August 28, 1936, and rehearing in the matter denied by the Supreme Court of the State of California on October 28, 1936, there was distributed to the taxpayer herein in the years 1936 and 1937 cash and other [17] assets.

(f) That the cash and other assets distributed to Barnhart-Morrow Consolidated by the co-trustees in the matter of Julian vs. Schwartz in the year 1936 was in accordance with Court Order dated July 23, 1934, which Court Order was ineffective during pendency of the appeal in said cause of action, but became effective on October 28, 1936 when the matter was finally determined and adjudicated.

(g) That pursuant to paragraph 24 of said judgment issued in the matter of Julian vs. Schwartz, the Court reserved jurisdiction to settle the account of the trustees pendente lite of Wells Nos. 1, 2, 3, 11, 16 and 17 and to order distribution of money now in the possession of said trustees and/or re-

ceiver in the matter, to the persons entitled thereto, as concluded in the conclusions of law therein.

(h) That after said Judgment in said cause of action of Julian vs. Schwartz became final, the said trustees ordered a final audit and report to be made of their accounts and records and that such audit was made by Geo. F. Meitner and Co., who rendered their audit report under date of February 9, 1937. That the original report of said audit made by said Geo. F. Meitner and Co. was filed with the Court subsequently thereafter. That the said auditors in said audit report called attention to the fact that the Commissioner of Internal Revenue was proposing to assess an income tax and penalties against said co-trustees for the calendar years 1931 to 1935 inclusive, in an amount aggregating \$102,264.92. That undoubtedly the Commissioner would propose an additional tax against the said co-trustees on the net income of the co-trustees for the period in the year 1936 during which said co-trustees operated said wells in said cause of action, and that it had been recommended in such audit report that a sum of not less than \$145,000.00 should be withheld from distribution to the respective proprietary interests to protect the said co-trustees against any liability [18] for the proposed assessments. That in February 1937 a further distribution of funds held by the co-trustees was ordered by the Court, and of the amount so ordered to be distributed, the taxpayer herein received the sum of \$63,000.00. That on August 13, 1937 a conference was held in Washington, D. C., by Geo. F. Meitner, Attorney in Fact for



the said co-trustees, with representatives of the Treasury Department relative to protest filed with the Treasury Department against the proposed assessments against said co-trustees, and at which hearing agreement was signed to the effect that no income tax liability for the years 1931 to 1936 would be assessed against the co-trustees, but that the recipients of the funds distributed by the co-trustees are liable for income taxes on the funds so distributed by the co-trustees are liable for income taxes on the funds so distributed for the year or years in which distribution is made to them. That pursuant to said agreement so filed with the Treasury Department said auditors, Geo. F. Meitner and Co., made their final audit and issued their report in connection therewith on September 22, 1937 and the original of said audit report was filed with the Court in said cause of Action of Julian vs. Schwartz.

(i) That on October 19, 1937 the Court made its order approving account of co-trustees and directing co-trustees to distribute funds and assign accounts.

(j) That at the commencement of said action of Julian vs. Schwartz, and the appointment of a receiver therein, instructions of the Court were given to the effect that proper records shall be kept with respect to the income and operating cost of each of the oil wells involved separately. That such records were kept and that the income and operating cost of each of the oil wells involved are sep-

arately shown in the audit reports filed with the Court in said cause of action, and that pursuant to paragraph 10 of said judgment, said Barnhart-Morrow Consolidated is the absolute owner of said Operating Agreement as amended and entitled to have paid to it out of the [19] proceeds of the sale of oil and gas from Wells Nos. 1, 2, 3, and 11, 65% of such proceeds exclusive of landowners royalties and provided further that the share of Barnhart-Morrow Consolidated shall bear and discharge all expenses of operating, maintaining, redrilling or otherwise endeavoring to keep said well or any of them on production.

(k) That paragraph 12 of said judgment decrees that Barnhart-Morrow Consolidated is entitled to 41-2/3% of the gross proceeds in Well No. 17 until the proceeds of 83-1/3% of the production of said well shall have produced since the commencement of this Action the additional sum of \$29,679.88, and thereafter 38% of the gross proceeds from said well.

(l) That paragraph 13 of said Judgment decrees that said Barnhart-Morrow Consolidated is the owner of an undivided one-half interest in Well No. 16 and to the possession thereof.

(m) That the gross proceeds of Julian Wells Nos. 1, 2, 3, 11, 16 and 17 as determined pursuant to the Judgment rendered by the Court in the matter of Julian vs. Schwartz and as detailed in the Audit Report dated February 9, 1937 made by Geo. F. Meitner & Company, which gross proceeds so determined due to Barnhart-Morrow Consolidated, are as follows:

Oil Wells	Oil and Gas Proceeds	Cash Discounts and Sale of Junk
Julian Well No. 1.....	\$112,034.39	\$ 343.09
Julian Well No. 2.....	123,852.50	343.08
Julian Well No. 3.....	102,478.08	343.09
Julian Well No. 11.....	16,308.89	358.06
Julian Well No. 16.....	63,529.28	343.08
Julian Well No. 17.....	68,627.01	343.10
Total.....	<u>\$486,830.15</u>	<u>\$2,073.50</u>

(8) (a) That on or about July 29, 1931 in an action brought in the Superior Court in and for the County of Los Angeles, known as Case No. 325061 by D. R. Morrow, as plaintiff, vs. Barnhart-Morrow Consolidated, a [20] corporation, and Guy L. Hardison and W. J. Barnhart under date of July 21, 1931, Ralph S. Armour was appointed receiver for the said Barnhart-Morrow Consolidated. That the said cause of action was filed in the Superior Court by the said D. R. Morrow for an accounting of the affairs of the corporation; for an accounting to the corporation by W. J. Barnhart, General Manager and Guy L. Hardison, President of the corporation, for any and all profits, including secret profits; and for unlawful payments as set forth in the Complaint; for contesting unlawful and excessive salaries paid to said Barnhart and Hardison; for their removal as officers of the corporation; and among other things set forth in the Complaint, for the appointment of a receiver to take charge of the affairs and assets of the corporation, pendente lite.

(b) That the said Ralph S. Armour, receiver for the corporation in said cause of action, was never



in complete charge nor had complete control of all of the assets of the corporation, since the oil properties, which said Barnhart-Morrow Consolidated had been operating prior to the appointment of receivers in the matter of C. C. Julian vs. Schwartz, were then in control and being operated by such receivers under orders of the Court issued in said cause of action. That at the time of the appointment of said Ralph S. Armour, as receiver, the said Barnhart-Morrow Consolidated was in an insolvent condition and continued to remain in such insolvent condition until the final adjudication of the matter of Julian vs. Schwartz and until such time that funds were released to it and to its Receiver to liquidate the receivership expenses of said Ralph S. Armour.

(c) That the said Barnhart-Morrow Consolidated was insolvent for the years 1931 to 1935 inclusive and until the final adjudication of the matter of Julian vs. Schwartz on October 28, 1936. [21]

(d) That pursuant to income tax returns and/or amendments thereto filed with the Treasury Department in Washington, D. C., and in connection with proposed additional assessments against the taxpayer for the years 1930, 1933 and 1934, and hearing had in Washington on August 13, 1937 relative to the proposed assessment for the said years above mentioned, the net income or losses of the taxpayer herein for each of the respective years were determined as shown below:

Year	Net Income or (Loss)*
1930 Net Income .....	\$ 3,175.54
1931 Net Loss .....	(90,116.67)*
1932 Net Loss .....	( 5,213.85)*
1933 Net Income .....	666.27
1934 Net Loss .....	( 2,516.00)*
1935 Net Loss .....	( 6,063.64)*

(e) None of the income impounded by the co-trustees in the matter of Julian vs. Schwartz was considered as income to the taxpayer herein until released to it. That in 1933 there was released for the account of taxpayer to J. A. Smith and in years subsequent thereto, pursuant to stipulation filed with the court in the year 1933, gas revenues produced by Julian Wells Nos. 1, 2, 3 and 11, accruing to Barnhart-Morrow Consolidated and which gas revenues pursuant to hearing held in Washington, D. C., on August 13, 1937, were determined to be income to Barnhart-Morrow Consolidated as having been constructively received by it in the year 1933 and in the years subsequent thereto. There was deducted from the income so considered as having been constructively received by the taxpayer, depreciation on the tangible equipment of the oil wells and other tangible lease equipment, which wells and other lease equipment were then being operated and/or used by the co-trustees in the matter of Julian vs. Schwartz. In addition to the depreciation so deducted there was also deducted and allowed business expenses paid and accrued, including legal fees and receivership expenses of Ralph S. Armour, receiver for the corporation. The receivership expenses so allowed, [22] were allowed as

deductions in and for the years in which they were definitely determined and approved by the Court in said cause of action No. 325061 wherein the said Ralph S. Armour was receiver.

(f) On November 12, 1936 Ralph S. Armour, receiver for said Barnhart-Morrow Consolidated filed his petition for approval to pay receiver's expenses with the Court in said cause of action No. 325061.

(g) That pursuant to hearing had the Court issued its order approving account and report of Ralph S. Armour, receiver, and directed termination of said receivership, that pursuant to said Petition and order of court issued in connection therewith, there was allowed and paid receiver's fees in the sum of \$6,143.32, auditing fees in the sum of \$1,875.00, legal fees in connection with the litigation of the case of Julian vs. Schwartz in the sum of \$7,400.00, appraiser's fees in connection with the sale of equipment salvaged from Hartley Well No. 1 in the sum of \$300.00 and insurance in the amount of \$333.53.

(9) (a) In December 1936 and in April 1937 Barnhart-Morrow Consolidated acquired by purchase "Regular and Special" Participating Oil Agreement interests in Julian Wells Nos. 1, 2 and 3.

(b) The Internal Revenue Agent in Charge is proposing to assess against Julian Wells Nos. 1, 2 and 3 Syndicates income taxes on the basis that the Syndicates are doing business in a corporate capacity, and are associations taxable as corporations. The "Regular and Special" Participating Oil Agreements acquired by Barnhart-Morrow Consolidated

are separate and distinct interests and/or estates in the residue from the proceeds from oil and the income received on the interests so held are depletable interests. Barnhart-Morrow Consolidated has been operating Julian Wells Nos. 1, 2 and 3 pursuant to its Operating Agreement as mentioned in paragraph (1) (c) hereof since [23] January 15, 1925, except for that period of time such wells were operated by the receiver and/or co-trustees in the matter of Julian vs. Schwartz and that at no time did the respective syndicates or the agent or agents thereof or the trustee operate said wells.

(c) Petitions have been filed with the United States Board of Tax Appeals by the Agents for Julian Wells Nos. 1, 2 and 3 Syndicates with respect to the proposed additional assessment for income taxes against such Syndicates by the Commissioner of Internal Revenue, which petitions are now pending hearing before and bear United States Board of Appeals Docket Numbers as follows:

	Docket No.
Julian Well No. 1 Syndicate .....	104172
Julian Well No. 2 Syndicate .....	104173
Julian Well No. 3 Syndicate .....	104174

and the facts as set forth in paragraph 5 of each of said petitions respectively is by reference made a part hereof as though fully set forth herein.

(d) In 1937 Barnhart-Morrow Consolidated received on the Participating Oil Agreement interests held by it in the respective oil wells, the following amounts:

Julian Well No. 1 Syndicate ..... \$10,000.00

Julian Well No. 1 Syndicate .....	\$ 5,450.00
Julian Well No. 2 Syndicate .....	5,235.85
Julian Well No. 3 Syndicate .....	3,340.65
<hr/>	
Total.....	\$ 14,026.50
<hr/>	

(10) (a) Barnhart-Morrow Consolidated did file capital stock tax returns for the fiscal years ending June 30, 1933, and June 30, 1934, and in each of said returns claimed exemption from any liability for capital stock taxes for the years ending on said dates on the basis that the said company was inactive, not doing business and in the hands of a receiver. The exemption claimed by said Barnhart-Morrow Consolidated in capital stock tax returns filed by it for the years 1933 and 1934 was sustained by the Commissioner of Internal Revenue [24] in accordance with letter received from said Commissioner of Internal Revenue under date of January 30, 1936, copy of which letter is attached hereto, marked Exhibit "B", and by reference made a part hereof as though fully set forth herein. The said letter did further exempt the said Barnhart-Morrow Consolidated from the filing of any capital stock tax returns for subsequent years and so long as its business was under the control and management of a court, state or federal liquidating official.

(b) Ralph S. Armour was appointed receiver for Barnhart-Morrow Consolidated on July 29, 1931, was not discharged as such receiver until November 27, 1936 and accordingly said Barnhart-Morrow Consolidated was not liable for the filing of any capital stock tax returns until and for the fiscal



year ending June 30, 1937. Said Barnhart-Morrow Consolidated filed its capital stock tax return for the fiscal year ending June 30, 1937 and pursuant to its original declaration of value in such return paid a capital stock tax in the amount of \$800.00. Said return was filed pursuant to the provisions of Section 105 of the Revenue Act of 1935, as amended by Section 401 of the Revenue Act of 1936. Liability for payment of capital stock tax for the fiscal year ending June 30, 1937 accrued as of the first day of business done by Barnhart-Morrow Consolidated in 1936 and after the dismissal of its receiver, said Ralph S. Armour.

(c) There was accrued as of December 31, 1937, pursuant to the provisions of the Revenue Act of 1935 as amended by the Revenue Act of 1936, then in effect, capital stock tax for the fiscal year ending June 30, 1938 in the amount of \$791.00.

(d) Pursuant to the provisions of Section 601 of the Revenue Act of 1938, which act became effective on May 28, 1938, and which act [25] granted to the taxpayer the right to re-declare its value for capital stock purposes, the said Barnhart-Morrow Consolidated filed its capital stock tax return for the fiscal year ending June 30, 1938 with a declared value of \$350,000.00, and paid a tax thereon of \$350.00.

(11) (a) The net income of Barnhart-Morrow Consolidated for the year 1936 is \$42,828.07.

(12) (a) The net income of Barnhart-Morrow Consolidated for the year 1937 was a loss of \$2,864.70.



(13) (a) At the time Ralph S. Armour was appointed receiver for Barnhart-Morrow Consolidated there had been accrued on said corporation's books and records as "accrued pay roll" payable to Guy L. Hardison the sum of \$14,000.00. The said amount was accrued at the rate of \$1,000.00 per month to July 31, 1931.

(b) There was also recorded on the Company's records and shown as due to Mr. Hardison on July 31, 1931, the sum of \$8,500.00 representing two notes payable, dated July 30, 1930, due one year after date; one note being issued for \$4,000.00 and a second note for \$4,500.00. That said amount of \$8,500.00 so set up as a liability to Mr. Hardison on the Company's records arose out of a purported transaction relative to Mr. Hardison selling to the Company a certain oil well derrick and equipment pertaining to Well No. 17. The issuance of said notes to the said Hardison was approved by a resolution passed by the Board of Directors on July 30, 1930.

(c) In September 1931 Geo. F. Meitner and Co. were appointed auditors for Ralph S. Armour receiver for Barnhart-Morrow Consolidated, who made an audit of the said Barnhart-Morrow Consolidated's books and records for the period September 1, 1928 to and including July 31, 1931 and submitted [26] their report in connection therewith under date of February 10, 1932. That said auditors questioned various transactions, which were also at issue in the suit filed by D. R. Morrow wherein said Ralph S. Armour was appointed receiver, and that

among such items questioned were the salaries accrued to W. J. Barnhart and Guy L. Hardison and the notes of \$8,500.00 issued to said Guy L. Hardison. That the salaries and other items questioned in said report pertaining to W. J. Barnhart were settled by the company and Mr. Barnhart in 1932, and Mr. Barnhart waived all of the salary accrued to his credit, except \$7,000.00 thereof, and assigned to the company an escrow account in the amount of \$25,000.00 pertaining to other claims the Company had against said Barnhart. On July 31, 1931 there had been accrued on said corporation's books and records as "accrued pay roll", payable to W. J. Barnhart, the sum of \$27,752.64, of which amount \$20,752.64 was cancelled in 1932. The major portion of the amount accrued as salary to Mr. Barnhart originated in 1930 and the Treasury Department in accordance with examination made by it for the year 1930 disallowed as excessive salary accrued in that year and because such salary was waived in 1932 the sum of \$20,752.64.

(d) The salary accrued to Guy L. Hardison in the amount of \$14,000.00 and the \$8,500.00 notes as set forth above, both of which items were in dispute, was not settled until December 11, 1936, on which date the Board of Directors authorized the payment of \$7,000.00 for salary to Mr. Hardison, which amount paid his salary accrued on the company's records to December 30, 1930. The balance of the salary which was accrued on the company's records from January 1, 1931 to July 31, 1931 at \$1,000.00 per month and during which time a Receiver was

appointed in the matter of Julian vs. Schwartz and the oil properties operated by such Receiver, the salary accrued [27] to Mr. Hardison was not recognized or paid.

(e) In the same resolution the Board of Directors of Barnhart-Morrow Consolidated refused to recognize or pay any amount to the said Hardison for the notes issued to him aggregating \$8500.00 in connection with the purported transaction involving Well No. 17.

(f) Shortly after the appointment of Ralph S. Armour as Receiver for said Barnhart-Morrow Consolidated, funds were not available with which to employ help and accordingly said Barnhart-Morrow Consolidated or its Receiver did not keep up its books or records of account.

(g) In November 1936, and after the litigation of Julian vs. Schwartz was finally determined and adjudicated, Barnhart-Morrow Consolidated engaged the firm of Geo. F. Meitner & Co., to bring its books and records up to date giving effect to the transactions pertaining to each of the years 1930, 1931, 1932, 1933, 1934, 1935 and 1936. Such transactions involved the settlement of the account with W. J. Barnhart in the year 1932; gas revenues which were considered constructively received by the company during the years 1933, 1934 and 1935; depreciation which the company sustained on its oil well equipment and general lease equipment for the years 1931 to 1936, all years inclusive; the transactions of Ralph S. Armour, Receiver for the company, in accordance with the petitions for and in

the years in which they were filed and approved by the court and the income from impounded funds in the matter of Julian vs. Schwartz due Barnhart-Morrow Consolidated, in accordance with the judgment rendered by the court in the matter.

(h) In accordance with such engagement the auditors gave effect to such transactions in the years in which they were paid and/or accrued or [28] definitely determined by the court, and pursuant to the resolution passed by the Board of Directors who did not recognize the company's liability to Mr. Hardison for the two notes amounting to \$8,500.00, said auditors cancelled such indebtedness in the year 1931 as of its date of origination in July 1930, reversing the charge to Well No. 17 equipment, thereby eliminating any deduction for depreciation on that amount from July 1930, but inadvertently failed to cancel in 1931 that portion of Mr. Hardison's salary which had been accrued in 1931 but not recognized or paid by the company.

(14) (a) On April 15, 1927 Barnhart-Morrow Consolidated loaned to one Ed. G. Westberg the sum of \$1,000.00 evidenced by note in favor of the company. Subsequently settlement of the note was made by Mr. Westberg through an assignment of a one per cent (1%) interest in a patent pertaining to improvements in the "art of removing oil from oil wells". Such interest in patent was determined to be valueless and authorized by the Board of Directors to be charged off on the books of the company in the year 1936.



(15) (a) In 1937 Barnhart-Morrow Consolidated paid to Hanna and Morton, its attorneys, the sum of \$900.00, covering services rendered by that firm at stockholders and directors meetings; in connection with application filed with the Securities Exchange Commission, pertaining to stock traded on the Los Angeles Stock Exchange and not in connection with any new issue of stock by the taxpayer; in the filing of Answers in the suit of Cargill vs. Barnhart-Morrow, et al., telegrams, messenger service and filing fees, all of which were paid and pertain to its regular business operations and are not in connection with the acquisition of title to any property or [29] organization costs of the taxpayer.

(16) (a) For the year 1937 there was accrued on the corporation's books the sum of \$300.17, being interest from March 15, 1937 to December 31, 1937 on Federal Income and State Franchise Taxes determined as payable on the net income of the taxpayer for the year ending December 31, 1936.

Wherefore, Petitioner prays that this Board may hear the proceeding and determine

(a) What constitutes Petitioner's gross income and net income from its oil wells for the years 1936 and 1937 and in connection therewith the amount of depletion allowance allowable as a deduction therefrom in determining Petitioner's net taxable income.

(b) That the deductions claimed and losses sustained by the Petitioner in the respective years of 1936 and 1937 are allowable deductions from the

gross income of the Petitioner in the respective years of 1936 and 1937 to which they pertain.

(c) That the Petitioner was insolvent and in receivership in the year 1936 and accordingly Petitioner is not liable for surtax on any undistributed profits for the year 1936.

(d) That the Participating Oil Agreements of the Petitioner in Julian Wells Nos. 1, 2 and 3 are direct interests or estates in the proceeds of oil produced from said wells and accordingly allowance for depletion shall be made with respect to the income received thereon, and

(e) For such other and further relief as the Board may deem just and proper. [30]

GEO. F. MEITNER,

C. P. A. O.K.

711 Wright and Callender  
Bldg., 405 So. Hill Street,  
Los Angeles, California

HAROLD C. MORTON,

Attorney O.K.

1126 Pacific Mutual Bldg.,  
523 West Sixth Street, Los  
Angeles, California

Counsel for Petitioner

[Duly Verified.] [31]



EXHIBIT "A"

(Copy)

SN-IT-1

Treasury Department  
Internal Revenue Service

12th Floor

U. S. Post Office and Court House,  
Los Angeles, California

Form 1230

Office of  
Internal Revenue Agent in Charge  
Los Angeles Division

IT:LA

PB-90D

Sep 18 1940

Barnhart-Morrow Consolidated,  
1009 Title Guarantee Building,  
411 West Fifth Street,  
Los Angeles, California

Sirs:

You are advised that the determination of your income tax liability for the taxable year(s) 1936 and 1937 discloses a deficiency of \$48,584.85 as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency mentioned.

Within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, Los Angeles, California, for the attention of IT:LA:FC. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,

GUY T. HELVERING

Commissioner,

By.....

(Signed)

GEORGE D. MARTIN

Internal Revenue Agent in  
Charge.

Enclosures:

Statement.

Form of waiver.

PB:fpc [32]

## STATEMENT

IT:LA

PB-90D

Barnhart-Morrow Consolidated,  
1009 Title Guarantee Building,  
411 West Fifth Street,  
Los Angeles, California.

Tax Liability For the Taxable Years Ended  
December 31, 1936 and December 31, 1937

	Years	Liability	Assessed	Deficiency
Income tax .....	1936	\$ 32,767.96	None	\$ 32,767.96
Income tax .....	1937	15,816.89	None	15,816.89
Totals .....		<u>\$ 48,584.85</u>	<u>None</u>	<u>\$ 48,584.85</u>

In making this determination of your income tax liability, careful consideration has been given to the report of examination dated May 11, 1939, to your protest dated August 31, 1939, and to the statements made at the conferences held on September 18, 1939, and subsequent dates.

The contention made in your protest that a deduction of \$1,000.00 not claimed in your return is allowable for the taxable year 1936, on account of loss due to worthlessness of a patent in which you had an interest, is denied in the absence of evidence that the patent became worthless in that year.

The contention made in your protest that a deduction of \$16,500.00 not claimed in your return is allowable for the taxable year 1936, as a bad debt due from C. C. Julian, arising from a payment of royalties in the amount of \$16,500.00 made during

the taxable year 1936 to J. A. Smith, is denied. It has not been shown that within the taxable year 1936 you ascertained said amount of \$16,500.00 to be a worthless debt and charged it off as a worthless debt. Section 23(k), Revenue Act of 1936. The payment of the said amount to J. A. Smith did not constitute an ordinary and necessary business expense properly accrued within the taxable year 1936 under the provisions of section 23(a) of the Revenue Act of 1936. [33]

It is determined that you were not insolvent at any time during the period of your receivership in the taxable year 1936 and you are, therefore, not exempt from surtax on undistributed profits under the provisions of section 14 of the Revenue Act of 1936.

If you do not acquiesce in all of the adjustments making up the deficiency indicated, but desire to stop the accumulation of interest on that part of the deficiency resulting from adjustments to which you agree, please fill out the enclosed form of waiver, inserting therein the amount of the deficiency you desire to have assessed at once. The execution of the form for the agreed portion of the deficiency will not deprive you of your right to petition the United States Board of Tax Appeals for a redetermination of the deficiency.

A copy of this letter and statement has been mailed to your representative, Mr. George F. Meitner, 405 South Hill Street, Los Angeles, California, in accordance with the authority contained in the power of attorney executed by you and on file with the Bureau. [34]

## Adjustments to Net Income

## Taxable Year Ended December 31, 1936

Net income as disclosed by return (loss).....\$(11,851.39)

## Additional income and unallowable deductions:

(a) Proceeds from impounded oil sales .....	\$142,989.99	
(b) Additional oil and gas sales.....	13.27	
(c) Equipment rental .....	5,000.00	
(d) Accrued salary cancelled.....	7,000.00	
(e) Accrued interest cancelled.....	391.67	
(f) Repairs disallowed .....	15.01	
(g) Receivership expenses disallowed .....	11,908.53	167,318.47

Total .....		\$155,467.08
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## Additional deductions:

(h) Field overhead expense .....	\$ 45.12	
(i) General and Administrative expenses .....	2,878.76	
(j) Taxes .....	881.47	
(k) Interest accrued .....	1,409.36	
(l) Overriding royalties .....	3,260.94	
(m) Depletion .....	43,089.65	51,565.30

Net income adjusted .....		\$103,901.78
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## Explanation of Adjustments

(a) The amount of \$142,989.99 received during the taxable year from impounded oil sales represents income of the taxable year, which was not included in your return. [35]

(b) Income from oil and gas sales included in your return is understated in the net amount of \$13.27, as follows:

Income from oil sales understated.....	\$ 5.95
Income from dry gas sales understated.....	49.79
<hr/>	
Total .....	\$55.74
Income from wet gas sales overstated.....	42.47
<hr/>	
Net adjustment .....	\$13.27

(c) Rental received on equipment in the amount of \$5,000.00 was not included in your return.

(d) The income reported in your return is increased by \$7,000.00, the amount of salary accrued in 1931 and cancelled by agreement in 1936.

(e) The income reported in your return is increased by \$391.67, the amount of interest accrued in prior years and cancelled in 1936.

(f) The deduction claimed for repairs, materials and supplies, \$373.03, is \$15.01 in excess of the correct amount, \$358.02.

(g) The amount of \$11,908.53 claimed in your return as a deduction on account of receivership expenses is disallowed for the reason that these expenses properly accrued prior to the taxable year. Section 23 of the Revenue Act of 1936.

(h), (i), (j), (k) and (l). These adjustments are made on account of allowable deductions not claimed in your return.

(m) Depletion is allowable under the provisions of sections 23(m) and 114(b)(3) of the Revenue Act of 1936 in the amount of \$4,622.52, which is \$43,089.65 in excess of the amount claimed in your return. [36]



## Computation of Tax

Taxable Year Ended December 31, 1936

## INCOME TAX

## Normal Tax

Taxable net income .....\$103,901.78

Normal-tax net income .....\$103,901.78

## Normal tax:

8% of \$ 2,000.00 .....\$ 160.00

11% of 13,000.00 ..... 1,430.00

13% of 25,000.00 ..... 3,250.00

15% of 63,901.78 ..... 9,585.27

Total normal tax ..... \$ 14,425.27

## Surtax on Undistributed Profits

Taxable net income .....\$103,901.78

Less: Normal tax ..... 14,425.27

Adjusted net income .....\$ 89,476.51

Undistributed net income .....\$ 89,476.51

## Surtax:

7% of \$ 8,947.65 .....\$ 626.34

12% of 8,947.65 ..... 1,073.72

17% of 17,895.30 ..... 3,042.20

22% of 17,895.30 ..... 3,936.97

27% of 35,790.61 ..... 9,663.46

[Figures in pencil]: 81476.51

Total surtax ..... \$ 18,342.69

Total normal tax ..... 14,425.27

Total income tax (normal tax and surtax).....\$ 32,767.96

Income tax assessed (normal tax and surtax):

Original, account No. 858053 ..... None

Deficiency of income tax .....\$ 32,767.96

[37]

## Adjustments To Net Income

Taxable Year Ended December 31, 1937

Net income as disclosed by return.....	\$	432.18
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## Additional income and unallowable deductions:

(a) Additional oil and gas sales.....	\$	582.59	
(b) Superintendent expense disallowed		1,109.49	
(c) Field salaries disallowed.....		277.50	
(d) Field overhead expense disallowed		56.93	
(e) Legal expense disallowed .....		400.00	
(f) Automobile and travel expense disallowed .....		53.76	
(g) General and administrative ex- pense disallowed .....		178.55	
(h) Miscellaneous operating costs disallowed .....		7.17	
(i) Insurance expense disallowed .....		32.47	
(j) Taxes disallowed .....		482.62	
(k) Depletion disallowed .....		16,163.40	
(l) Interest disallowed .....		300.17	
(m) Loss from abandonment of well No. 16 disallowed .....		38,984.02	
(n) Loss from collapse of casing and tubing disallowed .....		5,628.52	
(o) Loss from abandonment of Davis well disallowed .....		116.75	64,373.94

Total .....			\$ 64,806.12
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## Additional deductions:

(p) Depreciation .....	\$2,352.35	
(q) Repairs .....	187.92	
(r) Royalties .....	446.90	
(s) Fuel .....	23.10	3,010.27

Net income adjusted .....		\$ 61,795.85
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[38]

## Explanation of Adjustments

(a) Income from oil and gas sales included in your return is understated in the net amount of \$582.59, as follows:

Income from oil sales understated .....	\$589.14
Income from wet gas sales overstated.....	6.55
	<hr/>
Net adjustment .....	\$582.59

(b), (c), (d), (f), (h) and (i). These adjustments are made on account of deductions claimed in your return in excess of the respective amounts shown by your records.

(e) Attorney's fees in the amount of \$250.00 incurred in connection with registration of your capital stock claimed in your return are disallowed as not being deductible under the provisions of section 23 of the Revenue Act of 1936. Attorney's fees in the amount of \$150.00 incurred in connection with the acquisition of K.C.L. properties are likewise disallowed.

(g) This adjustment represents the disallowance, under the provisions of section 24 of the Revenue Act of 1936, of \$69.01 cost of furniture and fixtures claimed as a deduction in your return, and \$109.54 bank collection fees which has been allowed as a deduction for the preceding taxable year (included in adjustment (i) of the preceding taxable year.)

(j) The amount of \$441.00, representing an excessive accrual of Federal capital stock tax is disallowed under the provisions of section 23 of the Revenue Act of 1936. A further disallowance of

\$41.62 is made on account of deductions claimed in excess of the amount shown by your records.

(k) Depletion is allowable under the provisions of sections 23(m) and 114(b)(3) of the Revenue Act of 1936 in the amount of \$56,672.54, and since you claimed the amount of \$72,835.94 as a deduction in your return the amount of \$16,163.40 is disallowed. [39]

(l) The amount of \$300.17 claimed in your return as interest accrued on additional Federal income tax for 1936 is disallowed inasmuch as the liability for additional tax had not been determined or acknowledged. Section 23 of the Revenue Act of 1936.

(m) The amount of \$38,984.02 claimed in your return as loss on abandonment of your interest in well No. 16 is disallowed as not falling within the provisions of section 23 of the Revenue Act of 1936.

(n) The loss claimed in your return on account of collapse of casing and tubing in well No. 16 is excessive in the amount of \$5,628.52.

(o) The loss claimed in your return on account of abandonment of Davis well is excessive in the amount of \$116.75.

(p), (q), (r) and (s). These adjustments represent amounts of deductions allowable in addition to the respective amounts claimed in your return. [40]

Computation of Tax

Taxable Year Ended November 31, 1937

INCOME TAX

Normal Tax

Taxable net income .....	\$ 61,795.85
Less: Dividends received credit .....	11,922.52

Normal-tax net income .....	\$ 49,873.33
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Normal tax:

8% of \$ 2,000.00 .....	\$ 160.00
11% of 13,000.00 .....	1,430.00
13% of 25,000.00 .....	3,250.00
15% of 9,873.33 .....	1,481.00

Total normal tax .....	\$ 6,321.00
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Surtax on Undistributed Profits

Taxable net income .....	\$ 61,795.85
Less: Normal tax .....	6,321.00

Adjusted net income .....	\$ 55,474.85
Less: Dividends paid credit .....	6,949.77

Undistributed net income .....	\$ 48,525.08
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Surtax:

7% of \$ 5,547.49 .....	\$ 388.32
12% of 5,547.49 .....	665.70
17% of 11,094.97 .....	1,886.14
22% of 11,094.97 .....	2,440.89
27% of 15,240.16 .....	4,114.84

Total surtax .....	\$ 9,495.89
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Total normal tax .....	6,321.00
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Total income tax (normal tax and surtax) .....	\$ 15,816.89
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Income tax assessed (normal tax and surtax):

Original, account No. 857823 .....	None
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Deficiency of income tax .....	\$ 15,816.89
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## EXHIBIT "B"

(Copy)

## TREASURY DEPARTMENT

Washington

Jan 30 1936

Office of  
Commissioner of Internal Revenue  
Address reply to  
Commissioner of Internal Revenue  
and refer to  
MT:CST:ECB  
597824

Barnhart-Morrow Consolidated,  
1009 Title Guarantee Building,  
411 West Fifth Street,  
Los Angeles, California

Gentlemen:

Your capital stock tax return, Form 707, filed for the taxable year ended June 30, 1934, and the information submitted in connection therewith have been examined. The evidence discloses that the corporation was not doing business within the meaning of Section 701 of the Revenue Act of 1934, and your claim for exemption is therefor sustained.

It will not be necessary to file capital stock tax returns for this corporation for subsequent years as long as its business is under the control and management of a court, State or Federal liquidating official.



By direction of the Commissioner.

Respectfully,

(Signed)

.....  
D. S. BLISS

D. S. Bliss

Deputy Commissioner

cc—Los Angeles, California.

MT:CST:113

[Endorsed]: U. S. B. T. A. Filed Dec. 13, 1940.

[42]

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[Title of Board and Cause.]

ANSWER

The Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, for answer to the petition of the above-named taxpayer, admits and denies as follows:

1 and 2. Admits the allegations contained in paragraphs 1 and 2 of the petition.

3. Admits that the taxes in controversy are income taxes and surtaxes for the years 1936 and 1937; denies the remainder of the allegations contained in paragraph 3 of the petition.

4. Denies allegations of error contained in subparagraphs (a) to (p), inclusive, of paragraph 4 of the petition.

5. (1)(a) Admits that Barnhart-Morrow Consolidated was organized under the laws of the State of California under date of December 24, 1926; de-

nies the remainder of the allegations contained in subparagraph (1)(a) of paragraph 5 of the petition.

[43]

(1)(b) Admits that said Barnhart-Morrow Consolidated keeps its books and records on an accrual basis, and its income tax returns for the years 1936 and 1937 have been filed on the accrual basis in reporting net taxable income; denies the remainder of the allegations contained in subparagraph (1)(b) of paragraph 5 of the petition.

(1)(c) to (16)(a), inclusive. Denies the allegations contained in subparagraphs (1)(c) to (16)(a), inclusive, of paragraph 5 of the petition.

6. Denies each and every allegation contained in the petition not hereinbefore specifically admitted or denied.

Wherefore it is prayed that the determination of the Commissioner be approved.

(S) J. P. WENCHEL,

Chief Counsel, Bureau of  
Internal Revenue.

Of Counsel:

ALVA C. BAIRD,

Division Counsel.

FRANK T. HORNER,

E. A. TONJES,

Special Attorney, Bureau of  
Internal Revenue.

[Endorsed]: U. S. B. T. A. Filed January 29,  
1941. [44]

[Title of Board and Cause.]

## STIPULATION OF FACTS [45]

It Is Hereby Stipulated and Agreed, by and between the parties hereto, through their respective counsel, that the following facts are true: [46]

### I

That on November 10, 1931, Lem A. Brunson and Clara A. Brunson were the owners of the certain land described in a lease dated November 10, 1921, wherein the said Brunson and wife are lessors and the Globe Petroleum Company is lessee, which lease was executed and delivered on the date thereof and was recorded on December 9, 1921, in book 121, page 1 of Official Records in the office of the County Recorder of Los Angeles County, California. Said lease is referred to herein as the "Brunson Lease" and a true copy thereof is hereto attached and designated as Exhibit No. 1.

### II

That on or about June 2, 1922, the said Globe Petroleum Corporation, lessee under said Brunson Lease, executed and delivered a sublease to C. C. Julian as lessee, bearing said date, recorded June 27, 1922, in book 1180, page 252 of Official Records of Los Angeles County, California. Said sublease of June 2, 1922 from the Globe Petroleum Corporation to C. C. Julian is for convenience referred to as the "First Globe Lease" and a true copy thereof is hereto attached and designated as Exhibit No. 2.

## III

That on or about June 17, 1922, said C. C. Julian joined therein by his wife, Mary Julian, executed a certain document entitled "Assignment of Lease" to the Citizens Trust and Savings Bank, a corporation (now Citizens [47] National Trust and Savings Bank and referred to herein as Citizens Bank), with the written approval endorsed thereon by the Globe Petroleum Corporation; that said assignment was recorded August 4, 1922, in book 1223, at page 371 of Official Records of Los Angeles County, California. A copy of said assignment is attached hereto and designated as Exhibit No. 3. Said assignment for convenience will be referred to as "Well No. 1 Assignment".

That said Citizens Bank at or about the time of said assignment, executed a document entitled "Declaration of Trust", a copy of which is attached hereto and designated as Exhibit No. 4.

## IV

That following the execution and delivery of said Well No. 1 Assignment from C. C. Julian and Mary Julian, his wife, to said Citizens Bank and of said document entitled "Declaration of Trust", to wit: between June 17, 1922 and July 15, 1922, said C. C. Julian at and in the State of California executed and delivered to many persons as purchasers thereof documents entitled "Well No. 1 Participating Oil Agreements". Said participating oil agreements were known as and are hereby referred to as "Regular Well No. 1 Participating Oil Agree-

ments". That said "Regular Well No. 1 Participating Oil Agreements" so executed, sold [48] and delivered by said C. C. Julian are in the form attached hereto and designated as Exhibit No. 5. Said "Regular Well No. 1 Participating Oil Agreements" were substantially identical each to the other, except for the date, the number, the name of the purchaser and the amount of the fractional interest, which fractional interests were, as stated in said document, divided into 1750 parts. That all of said 1750 parts as defined in and as represented by said "Regular Well No. 1 Participating Oil Agreements" were issued, sold and delivered by said C. C. Julian to the purchasers thereof. That said 1750 parts relate to the proceeds of all of 49% of the oil produced from the oil well drilled on the land described therein, referred to and designated as Oil Well No. 1.

That said C. C. Julian also in the year 1922 executed, sold and delivered to numerous persons as purchasers thereof participating oil agreements in writing known as "Special Well No. 1 Participating Oil Agreements" in the form attached hereto, hereby referred to as Exhibit No. 6. Said "Special Well No. 1 Participating Oil Agreements" were substantially identical each to the other, except for the date, the number, the name of the purchaser and the amount of the fractional interest therein specified. All of said fractional interests aggregated 455 parts, each part being [49]  $1/35$ th of one per cent of a certain residue of the proceeds of the production of said Oil Well No. 1, as defined in said "Special Well No. 1 Participating Oil Agreements". That all of



said 455 parts as defined in said "Special Well No. 1 Participating Oil Agreements" were sold and delivered by said C. C. Julian and relate to all of the proceeds of 13% of the oil produced from said Well No. 1.

That the purchasers of said participating oil agreements paid to said C. C. Julian \$100.00 per each 1/1750th part of 70% or the residue of the proceeds of production from said Well No. 1 and \$100.00 per each 1/35th of 1% of the residue of the production from said Well No. 1, as defined in said documents.

That said Well No. 1 Participating Oil Agreements were acknowledged and at least one of said agreements was recorded prior to January 1, 1924, in the office of the County Recorder of Los Angeles County, California.

That said C. C. Julian also in 1922 executed, sold and delivered to various persons documents purporting to be assignments of a total of 8% of the production of said Well No. 1; that said purported assignments of each per cent of said 8% of the production thereof so assigned by said Julian was in the form hereto attached as Exhibit No. 7. [50]

That following the execution and delivery by C. C. Julian of said Regular and Special Well No. 1 Participating Oil Agreements and said per cent assignments to the various purchasers thereof, said Julian, to wit, in the year 1922, drilled on the land embraced in said Well No. 1 assignment to said Citizens Bank an oil well known as Well No. 1, down to what is known as the "Meyer Sand" under-



lying the surface of all of the land described in said Brunson Lease, at a depth of approximately 4600 feet. Said Well No. 1 was completed and placed on production and began the production of oil from said premises on or about March 26, 1923, and has since produced and is still producing oil therefrom.

## V

That under date of September 5, 1922, said C. C. Julian and Mary Julian, his wife, with written approval endorsed thereon by the Globe Petroleum Corporation, executed a certain document entitled "Assignment of Lease" to said Citizens Bank; that said assignment was recorded on October 5, 1922, in book 1382, page 347 of Official Records of Los Angeles County, California. A copy of said assignment is hereto attached as Exhibit No. 8. For convenience said assignment will be referred to as "Well No. 2 Assignment."

That said Citizens Bank at or about the time of said assignment, executed a document entitled "Declaration of Trust", a copy of which is hereto attached as Exhibit No. 9. [51]

## VI

That following the execution and delivery of said Well No. 2 Assignment from C. C. Julian and Mary Julian, his wife, to said Citizens Bank and of said document entitled "Declaration of Trust", to wit, between September 5, 1922 and December 31, 1922, said C. C. Julian at and in the State of California executed and delivered to many persons as pur-

chasers thereof documents entitled "Well No. 2 Participating Oil Agreements", relating to fractional interests in 70% of the net proceeds of the production of an oil well to be drilled on the premises described in said Well No. 2 Assignment. Said Participating oil agreements were known as and are hereby referred to as "Regular Well No. 2 Participating Oil Agreements". That said "Regular Well No. 2 Participating Oil Agreements" so executed, sold and delivered by said C. C. Julian are in the form hereto attached as Exhibit No. 10. Said "Regular Well No. 2 Participating Oil Agreements" were substantially identical each to the other, except for the date, the number, the name of the purchaser and the amount of the fractional interest, which fractional interests were, as stated in said documents, divided into 1750 parts. That all of said 1750 parts, as defined in and as represented by said "Regular Well No. 2 Participating Oil Agreements" were issued, sold and delivered by said C. C. Julian to [52] the purchasers thereof. That said 1750 parts relate to the proceeds of all of 49% of the oil produced from the oil well drilled on the land described therein, referred to and designated as Oil Well No. 2.

That said C. C. Julian also at the same time, that is to say, between September 5, 1922 and December 31, 1922, executed, sold and delivered to numerous persons as purchasers thereof participating oil agreements in writing known as "Special Well No. 2 Participating Oil Agreements" in the form attached hereto, hereby referred to and for identification designated as Exhibit No. 11. That said "Special Well No. 2 Participating Oil Agreements" were substan-

tially identical to the other, except for the date, the number, the name of the purchaser and the amount of the fractional interest therein specified. All of said fractional interests aggregated 455 parts, each part being  $1/35$ th of one per cent of a certain residue of the proceeds of the production of said Oil Well No. 2, as defined in said "Special Well No. 2 Participating Oil Agreements". That all of said 455 parts as defined in said "Special Well No. 2 Participating Oil Agreements" were assigned, sold and delivered by said C. C. Julian and they relate to all of the proceeds of 13% of the oil produced from said Well No. 2.

That the purchasers of said Participating Oil Agreements paid to said C. C. Julian \$100.00 per each  $1/1750$ th [53] part of 70% of the residue of the proceeds of production from said Well No. 2 and \$100.00 per each  $1/35$ th of 1% of the residue of the production from said Well 2 as defined in said documents.

That said Well No. 2 Participating Oil Agreements were acknowledged and at least one was recorded prior to January 1, 1924, in the office of the County Recorder of Los Angeles County, California.

That said C. C. Julian also in 1922 executed, sold and delivered to various persons documents purporting to assign to various persons a total of 8% of the production of said Well No. 2; that a true form of each of said purported assignments of each per cent or fraction of said 8% of the production thereof so assigned by said Julian is hereto attached as Exhibit No. 12.

That following the execution and delivery by C. C. Julian of said Regular and Special Well No. 2 Participating Oil Agreements and said per cent assignments to the various purchasers thereof, said Julian, to wit, in the year 1922 drilled on the land embraced in said Well No. 2 Assignment to said Citizens Bank an oil well known as Well No. 2 down to said "Meyer Sand". Said well No. 2 was completed and placed on production and began the production of oil from said premises on or about September 9, 1923, and has since produced and is still producing oil therefrom. [54]

## VII

That said Citizens Bank under date of February 5, 1923, executed a document entitled "Declaration of Trust", a copy of which is hereto attached and is hereby referred to as Exhibit No. 14.

## VIII

That following the execution of said document entitled "Declaration of Trust", to wit: prior to August 17, 1923, said C. C. Julian at and in the State of California executed and delivered to many persons as purchasers thereof documents entitled "Well No. 3 Participating Oil Agreements" relating to fractional interests in 70% of the net proceeds of the production of oil well to be drilled on the premises described in said Well No. 3 Assignment. Said participating oil agreements were known as and are hereby referred to as "Regular Well No. 3 Participating Oil Agreements". Said "Regular Well

No. 3 Participating Oil Agreements" so executed, sold and delivered by said C. C. Julian are in the form hereto attached as Exhibit No. 15. That said "Regular Well No. 3 Participating Oil Agreements" were substantially identical each to the other, except for the date, the number, the name of the purchaser and the amount of the fractional interest, which fractional interests were, as stated in said document, divided into 1750 parts. That all of said 1750 parts as defined in and represented by said "Regular Well No. 3 Participating Oil [55] Agreements" were sold and delivered by said C. C. Julian to the purchasers thereof; that said 1750 parts relate to the proceeds of all of 49% of the oil produced from the oil well drilled on the land described therein, referred to and designated as Oil Well No. 3.

That said C. C. Julian also at the same time, that is to say, prior to August 17, 1923, executed, sold and delivered to numerous persons "Special Participating Oil Agreements" in writing known as "Special Well No. 3 Participating Oil Agreements", in the form hereto attached, hereby referred to as Exhibit No. 16. That said "Special Well No. 3 Participating Oil Agreements" were substantially identical each to the other, except for the date, the number, the name of the purchaser and the amount of the fractional interest therein specified. All of said fractional interests aggregated 735 parts, each part being  $1/35$ th of one per cent of a certain residue of the proceeds of the production of said Oil Well No. 3 as defined in said "Special Well No. 3 Participat-



ing Oil Agreements". That all of said 735 parts as defined in said "Special Well No. 3 Participating Oil Agreements" were assigned, sold and delivered by said C. C. Julian and they relate to all of the proceeds of 21% of all the oil produced from said Well No. 3.

That the purchasers of said participating oil agreements paid to said C. C. Julian \$100.00 per each 1/1750th [56] part of 70% of the residue of the production from said Well No. 3 and \$100.00 per each 1/35th of 1% of the residue of the production from said Well No. 3, as defined in said documents.

That said Well No. 3 Participating Oil Agreements were acknowledged and at least two were recorded prior to January 1, 1924, in the office of the County Recorder of Los Angeles County, California.

That following the execution and delivery by C. C. Julian of said Regular and Special Well No. 3 Participating Oil Agreements, said Julian, to wit, in the year 1923, drilled on the premises embraced in said Well No. 3 Assignment to said Citizens Bank an oil well known as Well No. 3 down to said "Meyer Sand." Said Well No. 3 was completed and placed on production and began the production of oil from said premises on or about June 25, 1923, and has since produced and is still producing oil therefrom.

## IX

That said Wells Nos. 1, 2, and 3, upon their completion in said Santa Fe Springs oil field, for periods of time produced oil and gas in large quantities. Pro- [57] duction of said wells was under the



supervision and direction of said C. C. Julian. The production from said wells gradually declined and in the year 1924 had ceased to flow naturally and future production therefrom would require mechanical methods of production. The manner in which the production from said wells was sold and the distribution of the proceeds therefrom is hereinafter set forth.

## X

That on March 26, 1923, said Globe Petroleum Corporation, as lessor, executed another sublease to said C. C. Julian, as lessee, which was recorded April 23, 1923, in book 2129, page 49 of Official Records of Los Angeles County, California. That said lease of March 26, 1923, from said Globe Petroleum Corporation, as lessor, to said C. C. Julian, as lessee, is herein referred as the "Second Globe Lease." A true copy thereof is attached hereto and is hereby referred to as Exhibit No. 17.

## XI

That under date of April 21, 1923, said C. C. Julian, and Mary Julian, his wife, and John F. Beyer and [58] Loraine Beyer, his wife, and J. H. Roth, assigned to said Citizens Bank all their right, title and interest in and to said Second Globe Lease and in and to certain other oil leases not involved in this action, which assignment is hereinafter for convenience referred to as "Well No. 11 Assignment." That a true copy thereof is hereto attached as Exhibit No. 18. That said document was not recorded.

That said Citizens Bank on or about November 19, 1923, executed a document entitled "Declaration of Trust", a copy of which is hereto attached, designated as Exhibit No. 19.

## XII

That following the execution of said "Well No. 11 Assignment" by said Julian, Beyer and Roth to said Citizens Bank, and following the execution of said document entitled "Declaration of Trust", said Julian, Beyer and Roth executed and delivered to many persons as purchasers thereof documents purporting to assign interests in the production of Oil Wells Nos. 11 and 12, entitled "Participating Oil Agreements", relating to fractional interests in 50% of the net proceeds of the production of wells to be drilled on the premises of the production of wells to be drilled on the premises described in said assignment. Said participating oil agreements were known as "Wells No. 11, 12 and Pico Participating Oil Agreements". All of said "Wells No. 11, 12 and Pico Participating Oil Agreements" were substantially identical each to the other, except for the date, the number, the name of the purchaser and the amount [59] of the fractional interest, which fractional interests were, as stated in said document, divided in 7500 parts. That all of said 7500 parts as defined in said "Wells No. 11, 12 and Pico Participating Oil Agreements" were sold and delivered by C. C. Julian to the purchasers thereof. A true copy of said "Wells No. 11, 12 and Pico Par-

Participating Oil Agreements" is attached hereto as Exhibit No. 20.

That the purchasers of said fractional interests paid to said C. C. Julian, John F. Beyer and J. H. Roth, doing business as C. C. Julian & Company, \$100.00 per each 1/7500th part of 50% of the residue (as defined in said document) of the production from wells to be drilled on the land described in said Second Globe Lease.

### XIII

That in addition to said 50% of the residue of the production from premises described in said Second Globe Lease said Julian, Beyer and Roth executed, sold and delivered to various purchasers thereof documents purporting to assign interests in the production of Wells 11 and 12 by the assignment of one per cents or portions of one per cents thereof in the form hereto attached, hereby referred to as Exhibit No. 21.

### XIV.

That Well No. 11 mentioned and referred to in said Participating Oil Agreements executed and delivered by said Julian, Beyer and Roth was drilled on the premises [60] described in said Second Globe Lease in the year 1923 under said Participating Oil Agreements made by said Julian, Beyer and Roth and their assignments of percents in the production thereof, down to said "Meyer Sand" underlying said premises, and was completed and placed on production and began the production of oil in 1923 and has produced oil and gas intermittently since.

That Well No. 12 mentioned and referred to in said Participating Oil Agreements executed and delivered by said Julian, Beyer and Roth was also drilled on the premises described in said Second Globe Lease and for a time produced some oil, but said Well No. 12 was abandoned in the year 1927 and since then has never at any time produced any oil or other substances.

That the other property described in said "Wells No. 11, 12 and Pico Participating Oil Agreements" is not any part of the premises described in said Second Globe Lease.

## XV.

That on or about January 15, 1925, C. C. Julian, John F. Beyer and J. H. Roth, as parties of the first part, and D. R. Morrow and W. J. Barnhart, as parties of the second part, executed a certain document, a copy of which document is hereto attached, hereby referred to, and marked Exhibit No. 22.

That on or about April 16, 1925, Said D. R. Morrow [61] and W. J. Barnhart executed a purported assignment to Barnhart-Morrow, Inc. On or about January 19, 1927, said Barnhart-Morrow, Inc. executed a purported assignment to Barnhart-Morrow Consolidated, a California corporation. Said assignments appear on said Exhibit No. 22.

Under date of August 20, 1929, said Barnhart-Morrow Consolidated, by W. J. Barnhart as its president, wrote a letter addressed to C. C. Julian, a copy of which is hereto attached, hereby referred to and for identification marked Exhibit No. 23.

Under date of August 24, 1929, C. C. Julian wrote a letter addressed to Barnhart-Morrow Consolidated, a copy of which is hereto attached, hereby referred to and for identification marked Exhibit 24.

Under date of September 29, 1929, Barnhart-Morrow Consolidated, by W. J. Barnhart as its president, wrote a letter addressed to W. J. Wellman, a copy of which is hereto attached, hereby referred to and for identification marked Exhibit No. 25.

Said agreement and modifications thereof described in this paragraph relating to the operations of Barnhart and Morrow and Barnhart-Morrow Consolidated, will be for convenience referred to as the "Barnhart-Morrow Operating Agreement."

[62]

#### XVI.

That on March 9, 1928, United Oil Well Supply Company, Wm. B. Himrod and W. W. Hyams, and Lem A. Brunson and his wife, entered into a purported lease with one W. J. Barnhart, as lessee; that said purported lease was recorded on August 6, 1928, in book 7274, page 1 of official records of Los Angeles county, California. That a copy of said purported lease is designated as Exhibit No. 26. That said lease is referred to in the pleadings and is herein and hereafter for convenience referred to as the "United Lease".

#### XVII.

That thereafter, and on or about September 28, 1928, by a document entitled "Assignment of a Portion of Leased Premises" and recorded in book



7374, page 290 of official records of Los Angeles county, California, W. J. Barnhart, joined therein by his wife, Elsie D. Barnhart, executed a purported assignment to C. C. Julian, a copy of which assignment is hereto attached to Exhibit No. 27.

The exception in said documents describes the property on which Well No. 16 hereafter referred to was drilled.

### XVIII.

That under date of October 31, 1928, by document entitled "Assignment", which was recorded December 27, 1938, in book 7397, page 175 of official records of Los Angeles county, California, said A. L. Jameson, joined [63] therein by his wife, executed a purported assignment to the Santa Fe Springs Oil Company, a corporation. A copy thereof is marked as Exhibit No. 28.

That subsequent to said purported assignment to said Santa Fe Springs Oil Company by said A. L. Jameson and wife, said Santa Fe Springs Oil Company drilled an oil well on the land described in said Well No. 3 assignment from C. C. Julian to said Citizens Bank referred to in paragraph ..... hereof. The well so drilled by said Santa Fe Springs Oil Company is known as Well No. 17. It was drilled to a depth of 7000 feet or thereabouts, but did not produce from said depth.

That a document entitled "Operating Agreement", dated October 24, 1928, was executed by said C. C. Julian and A. L. Jameson, a copy of which is hereto attached, hereby designated as Exhibit No. 29.



That on July 9, 1930, a document bearing said date was executed by said Santa Fe Springs Oil Company, and W. J. Barnhart, a copy of which is hereto attached as Exhibit No. 30.

That thereafter, a document dated July 30, 1930, entitled "Operating Agreement", was executed by W. J. Barnhart and Barnhart-Morrow Consolidated, a corporation, a copy of which is marked Exhibit No. 31.

That thereafter said Barnhart-Morrow Consolidated operated said Well No. 17 and placed the same on produc- [64] tion from said "Meyer Sand" and has since continued to operate said Well No. 17 and received the production therefrom until said Well No. 17 was placed in the hands of the receiver appointed in the action of Julian v. Schwartz. That said Well No. 17 is still producing oil.

### XIX.

That said W. J. Barnhart, under date of October 20, 1928, executed an assignment to the Italo Petroleum Corporation of America of a portion of the premises described in the Second Globe Lease and included in the premises described in the assignment of said Second Globe Lease by C. C. Julian and said Beyer and Roth to the Citizens Bank hereinbefore referred to, upon which Well No. 11 was drilled. Said Italo Petroleum Corporation thereafter drilled three wells known as Italo No. 1, No. 2, and No. 3.

## XX.

That under date of September 28, 1928, said W. J. Barnhart and said Barnhart-Morrow Consolidated executed a certain document entitled "Operating Agreement", a copy of which is hereto attached, hereby referred to and marked Exhibit No. 32.

That said operating agreement, Exhibit No. 32, from Barnhart-Morrow Consolidated was recorded December 7, 1928, in book 7361, page 63 of official records of Los Angeles county, California.

That on the same date, and in the same place, there [65] was recorded a purported assignment by W. J. Barnhart and wife, executed by them on September 28, 1928, to Wm. M. Cady, of all rights of said W. J. Barnhart as reserved in said so-called operating agreement between said W. J. Barnhart and Barnhart-Morrow Consolidated, a copy of which is marked Exhibit No. 33.

That said Barnhart-Morrow Consolidated, subsequent to September 28, 1928, entered on the land described in "Well No. 2 Assignment" made by C. C. Julian to said Citizens Bank, and drilled thereon a certain oil well which is commonly known as Well No. 16 and commenced and continued to produce oil through said Well No. 16 from said "Meyer Sand" and until the appointment of receivers in Julian v. Schwartz, hereafter referred to, received the production of said Well No. 16.

## XXI.

Under date of September 28, 1928 C. C. Julian, W. J. Barnhart, and Barnhart-Morrow Consolidated executed a document, for convenience described as an option with respect to Well No. 16, providing that upon the payment to said Julian of \$2,500.00 said well need not be drilled below 5,000 feet, photostatic copy of which is marked Exhibit No. 34.

That on or about January 13, 1930 said \$2,500.00 was paid by Barnhart-Morrow Consolidated to C. C. Julian, the receipt for which was endorsed upon said document dated September 28, 1928, same being marked Exhibit No. 34. [66]

## XXII.

That on or about July 25, 1929, Wm. M. Cady executed a document entitled "Assignment of Agreement" to James B. Boyle, copy of which is hereto attached, marked Exhibit No. 35. (Same refers to the interest of said Cady in Well No. 16).

That on or about November 30, 1931 Wm. M. Cady and his wife executed a document entitled "Assignment" to J. A. Smith, to which document said James B. Boyle and his wife executed a consent, all of which appears from said assignment, Exhibit No. 35a. Said assignment from Cady to Smith conveyed among other things all interest of said Cady in Well No. 16 and a right of accounting of oil and gas produced therefrom.

That on or about November 30, 1931, Messrs. Wheat and Strong executed an assignment to J. A.

Smith, copy of which is hereto attached, marked Exhibit No. 36.

### XXIII.

That said Well No. 16 was completed at a depth of less than 5,000 feet (pursuant to said option of September 28, 1928, and the payment by Barnhart-Morrow Consolidated of \$2,500.00 (as hereinbefore described in Paragraph XXI hereof) and said well No. 16 produced from 83-1/3% of the production the sum of \$80,000.00 up to May 1930. Said C. C. Julian, by letter dated May 15, 1930, copy of which is hereto marked as Exhibit No. 37, directed Barnhart-Morrow Consolidated to pay to one H. B. Flesher the proceeds from [67] Well No. 16, payable to C. C. Julian for his interest in said Well No. 16 (being the same interest which had theretofore been assigned to said Cady by instrument dated September 28, 1928, being Exhibit No. 33).

That on or about July 18, 1930, the Barnhart-Morrow Consolidated advised C. C. Julian of claims of James B. Boyle to such moneys from Well No. 16, all as set forth in a copy of a written communication bearing said date, marked Exhibit No. 38.

Under date of July 28, 1930 C. C. Julian delivered to Barnhart-Morrow Consolidated a written document bearing said date, copy of which is hereto marked as Exhibit No. 39, which for convenience is referred to as the "Indemnity Agreement."

After receiving said Indemnity Agreement, Barnhart-Morrow Consolidated proceeded to pay said Flesher the sum of \$16,500.10 as proceeds of said

Well No. 16, payable after Barnhart-Morrow Consolidated had received the sum of \$80,000.00. To February 28, 1931 the total accruals to such interest payable (either to Boyle or Flesher) from said Well No. 16 amounted to \$22,672.63. No other payments were made as and for said interest in Well No. 16 until after the termination of the litigation here and now referred to.

#### XXIV.

In or about the year 1929 one Garliepp obtained a judgment against C. C. Julian in the State of California [68] in the amount of \$10,925.98. Said Garliepp caused execution to be issued against all the properties and wells hereinbefore described and caused an execution sale to be had of the same, at which sale one R. L. Mack became the purchaser. Said purchaser conveyed whatever interest he may have acquired by deed to one W. A. Schwartz. W. A. Schwartz thereupon claimed to be the owner of the wells hereinbefore described except for the land-owners' royalty interests.

Thereupon, and on or about January 1931, said C. C. Julian commenced an action in the Superior Court of the State of California in and for the County of Los Angeles, entitled "C. C. Julian vs. W. A. Schwartz", No. 315345, to restrain said Schwartz from taking possession of said wells or any of them. Said Schwartz thereupon filed a cross-complaint in said action, claiming to be the owner of said wells by reason of said execution sale and claiming that the holders of participating oil agree-



ments and percentage assignments had no interest in said wells, and claiming further that Barnhart-Morrow Consolidated had no interest therein. Such claims appear more particularly from a copy of the cross-complaint of said W. A. Schwartz filed in said action, a copy of which is made Exhibit No. 40 herein.

The holders of participating oil agreements in said Wells 1, 2, 3 and 11, by and through their agents or trustees, [69] Messrs. Redfield, Foster and Penn, filed a cross-complaint in said case of Julian v. Schwartz, wherein they claim to be the owners of the interest assigned to them, and further claim to be the owners of the production of certain other wells which had been drilled on premises covered by the Brunson lease. The claim of holders of participating oil agreements so asserted in their said cross-complaint appear more particularly from a copy of their cross-complaint, a copy of which is marked Exhibit No. 41, hereof.

## XXV.

In said case of Julian v. Schwartz, on or about March 19, 1931, David H. Cannon and Charles F. Allison were appointed receivers to take charge of and operate the oil wells upon the Brunson property, including said Wells 1, 2, 3 and 11, by order of court, copy of which is marked Exhibit No. 41A hereto. Thereafter, on April 30, 1931, said Charles F. Allison was named sole receiver for the same purposes pursuant to order, copy of which is hereto attached, marked Exhibit No. 42. Said Cannon



and Allison, and after his appointment as sole receiver, said Allison had possession of said wells, operated the same under the direction of the court in said action of Julian v. Schwartz pursuant to said orders. Thereafter, and on or about March 23, 1932, said Allison was removed as receiver by order of Court, and in his place and stead F. E. Foster and J. A. Smith were appointed trustees to operate said wells during [70] the pendency of the action in accordance with an order bearing date March 23, 1932, copy of which is hereto attached as Exhibit No. 43. Thereafter said F. E. Foster resigned his position created under said order of March 23, 1932, and C. L. Olson was by order of court appointed as successor to said F. E. Foster. Said Foster and Smith, and after the substitution of said Olson for Foster, said Olson and Smith, remained in possession of said wells and operated the same throughout the pendency of said case of Julian v. Schwartz. Said case of Julian v. Schwartz was decided by the Superior Court on or about September 7, 1933, and findings of fact and judgment made by said Superior Court, copies of which are marked Exhibit No. 44 and Exhibit No. 45 herein. Appeals were taken from said judgment of the Superior Court by said Schwartz and by Messrs. Redfield, Foster and Penn, acting on behalf of the holders of participating oil agreements, which said appeal was thereafter and on or about August 28, 1936, determined by a decision of the District Court of Appeal of the State of California reported in 16 Cal. App. (2d), page 310.

A petition to have the Supreme Court of the State of California hear said case of Julian v. Schwartz after decision by said District Court of Appeal, was by the said Supreme Court denied and said case finally determined in accordance with said opinion of the District Court of Appeal, on October 28, 1936. [71]

## XXVI.

During the pendency of the appeals in the case of Julian v. Schwartz, the Supreme Court of the State of California granted a supersedeas staying execution of the judgment without requiring a bond from appellants (see Julian v. Schwartz, 2 Cal. (2d) 280).

## XXVII.

After the final termination of said litigation Julian v. Schwartz, J. A. Smith, successor to Cady and Boyle of the one-half interest in said Well No. 16, presented to Barnhart-Morrow Consolidated claim for one-half of the funds accruing from production of well No. 16 after the receipt by Barnhart-Morrow of \$80,000.00, and said J. A. Smith demanded an accounting therefor (which sums included the \$16,500.10 paid to H. E. Flesher on the Indemnity Agreement of C. C. Julian as set forth in paragraph XXIII of this stipulation). Barnhart-Morrow Consolidated conceded that the payments theretofore made to Flesher were made in error and paid said sums to J. A. Smith pursuant to said demand. Said C. C. Julian had died in the year 1934 and left no estate, and Barnhart-Morrow Consolidated wrote off the sum of \$16,500.10 in said

year 1936, in which the sum was paid to J. A. Smith. A copy of said demand is attached as Exhibit No. 45-A.

### XXVIII.

Barnhart-Morrow Consolidated quitclaimed Well No. 16 and the premises in which the same was located to J. A. Smith on or about December 20, 1937, by quitclaim deed, [72] copy of which is marked Exhibit No. 46.

Said quitclaim was pursuant to resolution of the board of directors of Barnhart-Morrow Consolidated, copy of which is attached as Exhibit No. 47.

### XXIX.

That in addition to the operation by Barnhart-Morrow Consolidated of Julian Wells Nos. 1, 2, 3, 11, 16 and 17 located in the Santa Fe Springs Oil District in Los Angeles County, of the State of California, Barnhart-Morrow Consolidated operated oil wells in Kern County, California, known as K.C.L. Well No. 1, K.C.L. Well No. 2, K.C.L. Well No. 3, and K.C.L. Well No. 4, as lessee, from January 15, 1937, throughout the remainder of the year 1937.

### XXX.

That the cash distributed to Barnhart-Morrow Consolidated and Ralph S. Armour, receiver for Barnhart-Morrow Consolidated, by the co-trustees in the matter of Julian v. Schwartz in the year 1936 was in accordance with court order dated July 23, 1934, which court order was ineffective during pendency of the appeal in said cause of action, but

became effective on October 28, 1936, when the matter was finally determined and adjudicated. That the amount of cash so distributed to Barnhart-Morrow Consolidated in the year 1936 was \$112,000.00 and to Ralph S. Armour, receiver for Barnhart-Morrow Consolidated in the year 1936 was \$17,852.13. A copy of said order of July 23, 1934 is attached hereto as Exhibit No. 47-A. [73]

### XXXI.

That after said judgment in said cause of action of Julian v. Schwartz became final, the said trustees ordered a final audit and report to be made of their accounts and records and that such audit was made by Geo. F. Meitner and Co., who rendered their audit report under date of February 9, 1937. That the original report of said audit made by said Geo. F. Meitner and Co. was filed with the court subsequently thereafter. A copy of said report is attached hereto as Exhibit No. 48.

### XXXII.

That in February 1937 a further distribution of funds held by the co-trustees was ordered by the Court, and of the amount so ordered to be distributed, Barnhart-Morrow Consolidated received the sum of \$63,000.00, and on October 21, 1937 the sum of \$58,037.94 was paid to Barnhart-Morrow Consolidated.

### XXXIII.

That on August 13, 1937 a conference was held in Washington, D. C. by Geo. F. Meitner, attorney in

fact for the said co-trustees, with representatives of the Treasury Department relative to protest filed with the Treasury Department against the proposed assessments against said co-trustees, and at which hearing agreement was signed to the effect that no income tax liability for the years 1931 to 1936 would be assessed against the co-trustees, but that the recipients of the funds distributed by the co-trustees are liable for income taxes on the funds so dis- [74] tributed for the year or years in which distribution is made to them. Said agreement is Exhibit No. 49. That pursuant to said agreement so filed with the Treasury Department, said auditors, Geo. F. Meitner and Co., made their final audit and issued their report in connection therewith on September 22, 1937, and the original of said audit report was filed with the court in said cause of action of Julian v. Schwartz. A copy of said report is attached hereto as Exhibit No. 49-A.

That on October 19, 1937 the Court made its order approving account of co-trustees and directing co-trustees to distribute funds and assign accounts. Said order is Exhibit No. 50.

#### XXXIV.

That at the commencement of said action of Julian v. Schwartz, and the appointment of a receiver therein, instructions of the Court were given to the effect that proper records shall be kept with respect to the income and operating cost of each of the oil wells involved separately. That such records were kept by the co-trustees and that the income and



operating cost of each of the oil wells involved are separately shown in the audit reports filed with the Court in said action, which reports are Exhibits Nos. 48 and 49-A herein.

### XXXV.

That on or about July 29, 1931, in an action brought in the Superior Court in and for the County of Los Angeles, [75] known as case No. 325061, by D. R. Morrow, as plaintiff v. Barnhart-Morrow Consolidated, a corporation, and Guy L. Hardison and W. J. Barnhart under date of July 21, 1931, Ralph S. Armour was appointed receiver for the said Barnhart-Morrow Consolidated (Exhibit 50-A). That the said cause of action was filed in the Superior Court by the said D. R. Morrow for an accounting of the affairs of the corporation; for an accounting to the corporation by W. J. Barnhart, General Manager, and Guy L. Hardison, President of the corporation, for any and all profits, including secret profits; and for unlawful payments as set forth in the complaint; for contesting unlawful and excessive salaries paid to said Barnhart and Hardison; for their removal as officers of the corporation; and among other things set forth in the complaint, for the appointment of a receiver to take charge of the affairs and assets of the corporation, pendente lite (Exhibit 50-B).

### XXXVI.

That the said Ralph S. Armour, receiver for the corporation in said cause of action, was never in complete charge nor had complete control of all of

the assets of the corporation, since the oil properties at Santa Fe Springs, which said Barnhart-Morrow Consolidated had been operating prior to the appointment of receivers in the matter of *C. C. Julian v. Schwartz*, were then in control and being operated by such receivers under orders of the court [76] issued in said cause of action.

A schedule showing balance sheets of Barnhart-Morrow Consolidated, as per its books for the years 1930 to 1935, is hereto attached, marked Exhibit No. 51. Referring to said balance sheets, the items under the heading "Capital Assets" (except the items pertaining to the Long Beach Hartley Well and Office furniture and fixtures) were not in the possession of Barnhart-Morrow Consolidated from the time of the appointment of the receivers and/or trustees in the case of *Julian v. Schwartz* in 1931 until the final determination of that litigation in October 1936, but, on the contrary, said receivers and/or trustees had possession of the same pursuant to court orders in said action, and all of said assets were claimed by said Schwartz and by the holders of Participating Oil Agreements as asserted in said action.

### XXXVII.

That pursuant to income tax returns and/or amendments thereto filed with the Treasury Department in Washington, D. C., and in connection with proposed additional assessments against the Barnhart-Morrow Consolidated for the years 1930, 1933 and 1934, and hearing had in Washington on August 13, 1937 relative to the proposed assessment for the

said years above mentioned, the net income or losses of Barnhart-Morrow Consolidated herein for each of the respective years were determined as shown below: [77]

Year	Net Income or (Loss)*
1930 Net income .....	\$ 3,175.54
1931 Net Loss .....	(90,116.67)*
1932 Net Loss .....	( 5,213.85)*
1933 Net Income .....	666.27
1934 Net Loss .....	( 2,516.00)*
1935 Net Loss .....	( 6,063.64)*

### XXXVIII.

None of the income impounded by the co-trustees in the matter of Julian v. Schwartz was considered as income to Barnhart-Morrow Consolidated until released to it. That in 1933 there was released for the account of Barnhart-Morrow Consolidated to J. A. Smith, and in years subsequent thereto, pursuant to stipulation filed with the Court in 1933, gas revenues produced by Julian Wells Nos. 1, 2, 3 and 11, accruing to Barnhart-Morrow Consolidated, and which gas revenues pursuant to hearing held in Washington, D. C., on August 13, 1937, were determined to be income to Barnhart-Morrow Consolidated as having been constructively received by it in the year 1933 and in the years subsequent thereto. There was deducted from the income so considered as having been constructively received by the Barnhart-Morrow Consolidated, depreciation on the tangible equipment of the oil wells and other tangible lease equipment, which wells and other lease equipment were then being operated and/or used

by the co-trustees in the matter of Julian v. Schwartz. In addition to the depreciation so deducted, there was also deducted and allowed business expenses paid and accrued, [78] including legal fees and receivership expenses of Ralph S. Armour, receiver for the corporation. The receivership expenses so allowed, were allowed as deductions in and for the years in which they were definitely determined and approved by the Court in said cause of action No. 325061 wherein the said Ralph S. Armour was receiver.

### XXXIX.

On November 12, 1936, Ralph S. Armour, receiver for said Barnhart-Morrow Consolidated, filed his petition for approval to pay receiver's expenses with the Court in said cause of action No. 325061. Said petition is Exhibit No. 52.

### XL.

That pursuant to hearing had, the Court issued its order approving account and report of Ralph S. Armour, receiver, (Exhibit 52-A).

### XLI.

Barnhart-Morrow Consolidated did file capital stock tax returns for the fiscal years ending June 30, 1933, and June 30, 1934, and in each of said returns claimed exemption from any liability for capital stock taxes for the years ending on said dates on the basis that the said company was inactive, not doing business and in the hands of a receiver. The exemption claimed by said Barnhart-Morrow Con-

solidated in capital stock tax returns filed by it for the years 1933 and 1934 was sustained by the Commissioner of Internal Revenue, in accordance with letter received [79] from said Commissioner of Internal Revenue under date of January 30, 1936, copy of which letter is attached hereto, marked Exhibit No. 53.

Barnhart-Morrow Consolidated did not file capital stock tax returns for the fiscal years ending June 30, 1935 and June 30, 1936, but did file a capital stock tax return for the fiscal year ending June 30, 1937 on September 29, 1937, pursuant to extension granted to that date in which to file such return, with an Original Declared Value of Entire Capital Stock of \$800,000.00 and paid the tax shown due thereon of \$800.00.

## XLII.

On July 29, 1931, at which time Ralph S. Armour was appointed receiver for Barnhart-Morrow Consolidated, there had been accrued on said corporation's books and records as "accrued payroll" payable to Guy L. Hardison the sum of \$14,000.00. The said amount was accrued at the rate of \$1,000.00 per month to July 31, 1931.

There was also recorded on the Company's records and shown as due to Mr. Hardison on July 31, 1931, the sum of \$8,500.00 representing two notes payable, dated July 30, 1930, due one year after date; one note being issued for \$4,000.00 and a second note for \$4,500.00. That said amount of \$8,500.00 so set up as a liability to Mr. Hardison on the Company's records arose out of a purported transaction relative



to Mr. Hardison selling to the company a [80] certain oil well derrick and equipment pertaining to Well No. 17.

The salary accrued to Guy L. Hardison in the amount of \$14,000.00 and the \$8,500.00 notes as set forth above, both of which items were in dispute, was not settled until December 11, 1936, on which date the board of directors authorized the payment of \$7,000.00 for salary to Mr. Hardison, which amount paid his salary accrued on the company's records to December 30, 1930 (Exhibit No. 54). The balance of the salary of Mr. Hardison which was accrued on the company's records from January 1, 1931 to July 31, 1931, at \$1,000.00 per month, during which time a receiver was appointed in the matter of Julian v. Schwartz and the oil properties operated by such receiver, was not recognized or paid (Exhibit No. 54).

#### XLIII.

That pursuant to a resolution of the board of directors, dated March 5, 1937, a copy of which is attached hereto as Exhibit No. 55, Barnhart-Morrow Consolidated paid a dividend in the amount of \$6,949.77 on April 5, 1937.

#### XLIV.

In December 1936 and in April 1937 Barnhart-Morrow Consolidated acquired by purchase certain "Regular and Special" Participating Oil Agreement interests in Julian Wells Nos. 1, 2 and 3, on account of which Barnhart-Morrow Consolidated

was paid the amount of \$14,026.50 in 1937, [81]  
which amount for the year 1937 constitutes dividends received.

Dated this 3rd day of October, 1941.

J. P. WENCHEL,

[Illegible initials.]

Chief Counsel Bureau of Internal Revenue.

HAROLD C. MORTON,

B. W. BURKHEAD,

Counsel for Petitioner.

[Endorsed]: U.S.B.T.A. Filed Oct. 4, 1941. [82]

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[Title of Board and Cause.] [83]

United States Post Office and Court House,  
Los Angeles, California,

October 4, 1941. 9:35 o'clock a. m.

Before:

Hon. Richard L. Disney

Met pursuant to notice.

Appearances:

B. W. BURKHEAD and

HAROLD C. MORTON,

1126 Pacific Mutual Building,

Los Angeles, California,

Appearing for Barnhart-Morrow Consolidated, the Petitioner.

E. A. TONJES,

Appearing for the Commissioner of Internal Revenue, Respondent. [84]

## PROCEEDINGS

The Clerk: 105859, Barnhart-Morrow Consolidated.

The Member: State the appearances and case for the petitioner.

The Clerk: B. W. Burkhead of 1126 Pacific Mutual Building, Los Angeles, for the petitioner; Mr. E. A. Tonjes for the respondent.

Mr. Burkhead: Mr. Harold C. Morton, 1126 Pacific Mutual Building, also for the petitioner. He appears on record for the petitioner.

Mr. Morton: Your Honor will recall ten days ago on this matter the Julian Syndicates were first called on this calendar and I made a descriptive statement and suggested that in the interests of time and a better understanding of the matter and a better presentation, an attempt would be made to stipulate to the facts in both those cases, that is, the syndicate cases and this case. The syndicate cases have been disposed of by a stipulation covering the entire matter.

In the Barnhart-Morrow matter, the case before your Honor, a stipulation has been entered into between counsel for the parties, some 35 pages in writing, which identify 54 documents to be marked as exhibits, and at this time I can present to the Clerk the original of that stipulation, together with the documents which are referred to and which the Clerk will find have been marked with the appropriate [86] exhibit numbers so he will have no trouble giving his appropriate designations to them. They bear the same numbers.

The Member: These documents, I take it, all come in without objection?

Mr. Morton: That is right. They all have been stipulated to and have been covered fully and come in without objection.

The Member: They are not attached?

Mr. Morton: Physically they could not be attached. As a matter of fact, the stipulation will in some instances refer to the fact that the exhibit is attached. As a matter of fact, it is not physically attached, so the record will be clear on that.

The Member: Well, let the stipulation be filed and the facts therein set forth; and the exhibits numbering from 1 to 55 inclusive are on the part of the petitioner, are they, or are they joint exhibits? You have stipulated those facts. I suppose they should be joint exhibits.

Mr. Morton: We will offer them. They may be deemed our exhibits or joint. It doesn't matter. Both parties of necessity have to have them.

The Member: It is simpler to call them petitioner's exhibits, and under the circumstances we will do that.

Petitioner's Exhibits 1 to 55 inclusive are admitted in evidence. [87]

(The said exhibits, so offered and received in evidence, were marked Petitioner's Exhibits 1 to 55, and made a part of this record.)

## PETITIONER'S EXHIBIT No. 41

(Copy)

(Excerpts From Exhibit 41)

Cross-Complaint of L. V. Redfield, F. E. Foster and H. A. Penn (on behalf of Holders of Participating Oil Agreements) in the Case of Julian vs. Schwartz, No. 315345.

Come now L. V. Redfield, F. E. Foster and H. A. Penn, and file this their cross-complaint herein. For convenience in this cross-complaint, the cross-complaints will be referred to as "complaints" and the cross-defendants will be referred to as "defendants".

On behalf of themselves and all other holders of "Well No. One Participating Oil Agreements", "Well No. Two Participating Oil Agreements", "Well No. Three Participating Oil Agreements" and "Wells No. 11 and 12 Participating Oil Agreements" hereinafter referred to, who may join as complainants herein, these complainants allege:

\* \* \* \* \*

## IX.

Said C. C. Julian and his wife, Mary Julian, also to wit: on June 17, 1922, transferred and assigned said First Globe Lease and all their interest in said Brunson Lease to said Citizens Bank insofar as the same covered or affected the north 209 feet of the east 209 feet of the westerly 543 feet of the land described in said First Globe Lease to said C. C.



Julian, in trust and as trustee to hold the same for twenty-five years for the use and benefit of the assigns of said C. C. Julian of the petroleum produced from said premises and set aside said premises as an exclusive drilling site of an oil well thereon to be known as Well No. Two; that said assignment was accepted by said Citizens Bank as trustee and was recorded on October 5, 1922 in book 1382, page 347 of official records of Los Angeles county in the office of the county recorder thereof. A true copy thereof is hereto attached, marked "Exhibit E" and made a part of this cross-complaint.

Under said assignment and as trustee of said premises, the said Citizens Bank on or about June 17, 1922 made its declaration of trust which was substantially the same in form and effect as the declaration of trust covering the property assigned and set aside as the drilling site for Well No. One except that it set forth the property described in Well No. Two assignment.

Thereafter defendant Julian, in consideration of moneys furnished him for drilling an oil well on said drilling site or premises known as Well No. Two, sold and assigned to purchasers thereof undivided interests in the net production of oil from said oil well on said premises and the net proceeds of the sale of oil produced in said premises, and made and entered into agreements with each and all of the purchasers of said participating interests identical with the agreements made by the defend-

ant Julian with purchasers of participating interests in Well No. One. Said participating agreements are referred to as "Well No. Two Participating Oil Agreements."

Said participating interests and agreements on the part of defendant Julian were made assignable and the complainants herein are now the owners and holders of a large number thereof, the total holdings of these complainants of such participating units now representing the right to more than twenty per cent (20%) of the net production of petroleum from said premises designated as Well No. Two.

Said "Well No. Two Participating Oil Agreements" were acknowledged so as to entitle the same to recordation and at least one was recorded prior to January 1, 1924 in the office of the county recorder of Los Angeles county to wit: on September 28, 1922, in book 1221 at page 186 of official records.

With moneys so furnished by the purchasers of said "Well No. Two Participating Oil Agreements", defendant Julian drilled an oil well on said Well No. Two drilling site, which is known as Well No. Two and oil has been produced from said Well No. Two since November, 1922 and is now being produced from said well.

\* \* \* \* \*

## XVII.

Defendants Julian, Beyer and Roth have defaulted in the performance of the covenants contained in their said participating agreements with

the purchasers of interests in said "Second Globe Lease" and in the production from said wells No. 11 and No. 12, in that said defendants discontinued the operation thereof; that contrary to their said agreements with the purchasers of interest in said oil wells Nos. 11 and 12, said Julian, Beyer and Roth on or about January 15, 1925, delivered the possession and operation of said oil wells over to the defendants D. R. Morrow and W. J. Barnhart and entered into a written agreement with said D. R. Morrow and W. J. Barnhart purporting to give to said defendants Morrow and Barnhart the full right and power to operate said oil wells and to have and receive 50% of the gross production of said wells, without any deduction therefrom for the costs and expenses of operating said wells, all without the consent of these complainants or other owners of interest in said oil wells; that in violation of their said agreements defendants Julian, Beyer and Roth authorized and permitted said D. R. Morrow and W. J. Barnhart, and the defendant Barnhart-Morrow, Inc., and Barnhart-Morrow Consolidated, as successors and assigns of said D. R. Morrow and W. J. Barnhart to continue in the possession and operation of said oil wells Nos. 11 and 12, and to receive and dispose of the production thereof and to have and receive a large portion of the proceeds from the production of said wells to which the holders of said participating interests are entitled;

That said oil wells Nos. 11 and 12 have not been

operated in the manner provided for in said agreements by said lessees; that the oil produced therefrom has not been marketed in the manner provided for in said agreements; that the proceeds from the sale of oil have not been disposed of as provided for in said agreements; that the costs, charges and expenses incurred in the operation, maintenance and management of said well have not been paid upon presentation by said lessees or their nominees of proper bills and statements therefor accompanied by the affidavits of said lessees or their nominees that said charges, costs and expenses were necessarily and properly incurred in connection with said operation, maintenance and management of said wells; and all of the proceeds from the sale of the production of said wells have not been paid to said Citizens Bank and distributed by said bank in the manner provided for in said agreements.

And on information and belief, these complainants allege that the abandonment of the operation of said wells Nos. 11 and 12 by defendants Julian, Beyer and Roth, and the delivery by them of the possession thereof to said Morrow and Barnhart and their successors and their agreements with said Morrow and Barnhart and their successors in connection with the operation of said oil wells were all for the purpose and to the end that said C. C. Julian should receive secret profits and moneys to which the holders of said participating interests were and are entitled from the proceeds of the production of oil from said oil wells.

\* \* \* \* \*

## XX.

Complainants allege and claim that all oil produced from trespassing Well No. 14 and the proceeds thereof belong to the holders of participating interests in said oil well No. 1; that all oil produced from said trespassing Well No. 16 and the proceeds thereof belong to the holders of participating interests in said oil well No. 2; that all oil produced from said trespassing Wells No. 15 and No. 17 and the proceeds thereof belong to the holders of participating interests in said oil well No. 3; that all oil produced from said trespassing Italo Wells Nos. 1, 2 and 3 and the proceeds thereof belong to the holders of participating interests in said oil wells Nos. 11 and 12. Complainants are entitled to an accounting from the defendants W. J. Barnhart, D. R. Morrow, C. C. Julian, Santa Fe Springs Oil Company, Italo Petroleum Corporation and their successors and from the receiver appointed in this action and from all other persons who have received or hold oil or the proceeds from the sale of oil from any of said wells Nos. 14, 15, 16 and 17 or from said Italo Wells Nos. 1, 2 and 3, and to have the amount due them as proceeds from the sale of oil produced from said trespassing wells ascertained and determined.

\* \* \* \* \*

Wherefore, complainants, pray for orders, decrees and judgments of this court as follows:

\* \* \* \* \*



3. That it be adjudged and decreed that said "United Lease" to defendant W. J. Barnhart conveyed no right, title or interest in any of the premises embraced and described in said first and second Globe leases or in either of them; that said "United Lease" was made in violation of said first and second Globe leases and is void; that all acts of said defendant W. J. Barnhart and/or of his assigns in entering upon any of the premises described in said first and second Globe leases or either of them under said United Lease and the drilling and operating of said Wells Nos. 14, 15, 16 and 17 and said Italo Wells Nos. 1, 2 and 3, and producing oil therefrom are trespasses upon the rights and interests of these complainants and others holding as assignees of C. C. Julian under said first and second Globe leases.

\* \* \* \* \*

7. That defendant C. C. Julian be removed as agent for complainants and other holders of participating interests in said Wells 1, 2 and 3, either in the operation of said oil wells or in the disposition of the production or proceeds from the sale of the production thereof and from any office or position of trust in connection therewith and that the possession of said oil wells and the premises embraced in their drilling sites and the right to operate the oil wells drilled thereon for the benefit of those entitled to the production thereof to be given the owners of the participating interests in each of said wells Nos. 1, 2 and 3 or to such com-

petent person or persons as the holders of said participating interests may designate as their agency for that purpose.

8. That defendants Julian, Beyer and Roth be removed as agent for complainants and other holders of participating interests in said Wells 11 and 12, either in the operation of said oil wells or in the disposition of the production or proceeds from the sale of the production thereof and from any office or position of trust in connection therewith and that the possession of said oil wells and the premises embraced in their drilling sites and the right to operate the oil wells drilled thereon for the benefit of those entitled to the production thereof be given the owners of the participating interests in said Wells 11 and 12, or to such competent person or persons as the holders of said participating interests may designate as their agency for that purpose.

9. That defendants C. C. Julian, W. J. Barnhart, D. R. Morrow, Barnhart-Morrow Consolidated Barnhart & Morrow Inc., United Oil Well Supply Company, Wm. B. Himrod, W. W. Hyams, Citizens National Trust and Savings Bank, Syndicates Distributors Inc., Sunset Pacific Oil Company, Hercules Gasoline Company, Italo Petroleum Corporation, Santa Fe Springs Oil Company, El Camino Oil Corporation, and defendants Richard Roe One to Fifty inclusive and defendants Richard Roe Corporations One to Five inclusive, and each

of them, be ordered to account for all oil and all proceeds from the sale of oil produced from any of the oil wells on the land embraced and described in said first and second Globe leases, or either of them, and that upon such accounting the amount of such oil and/or proceeds thereof to which each of these complainants and others holding similar participating interests under said Wells Nos. 1, 2 and 3 and 11 and 12 participating oil agreements who may join as complainants herein are entitled shall be determined and each of such complainants herein shall be given separate judgments against each of said defendants for the amount so found to be due each such complainant from each such defendant.

OLSON AND OLSON

By CULBERT L. OLSON

Attorneys for Cross-Complainants.

[Endorsed]: U.S.B.T.A. Filed Oct. 4, 1941.

## PETITIONER'S EXHIBIT No. 47

Minutes of a Meeting of the Board of Directors of  
Barnhart-Morrow Consolidated Held December  
17, 1937

A meeting of the Board of Directors of Barnhart-Morrow Consolidated was held at the office of the corporation, 1009 Title Guarantee Bldg., Los Angeles, California, on December 17, 1937 at four o'clock P.M.

All directors were present.

The minutes of the previous Director's Meeting held October 8, 1937 were read and approved.

Mr. Stabler reported that the joint venture well in the Tejon area tested 1400# pressure and it had been decided to kill same and drill for possible deeper oil sand. Discussion was held relative to the drilling of another well as a joint venture with the same companies in the Tejon area if the present well being drilled proves to be a commercial well. It was moved by Mr. Stabler, seconded by Mr. Brandt and carried, that Barnhart-Morrow Consolidated join with Universal Consolidated and Wilshire Oil Company in the drilling of a second well in the Tejon area providing the present well proves a success and if the other companies so decide.

It was moved by Mr. Morton, seconded by Mr. Brandt, Mr. Smith not voting, that the following resolution be adopted:

Whereas in view of the small production and *and* interest in Well #16 at Santa Fe Springs, it is deemed not profitable to operate this well, and

Whereas J. A. Smith is the owner of a paramount title to the lease on which this well is located, and is willing to accept a quitclaim deed to this well:

Resolved: that Barnhart-Morrow Consolidated release, surrender and quitclaim unto J. A. Smith the following

That certain oil well in the Santa Fe Springs Oil Field commonly known as Julian Well No. Sixteen (16), together with the premises pertaining thereto, described as that portion of the West Five Hundred Forty-three (543) feet of the North half of the North half of the Northeast quarter of the Southwest quarter of Section 6, Township 3 South, Range 11 West, S.B.B.&M., Los Angeles County, California, commencing at a point in the northerly line thereof Five Hundred Forty-three (543) feet distant from the Northwest corner of said property; thence South One Hundred Fifty (150) feet on a line parallel with the Westerly boundary line of said property to a point; thence West Two Hundred (200) feet and parallel with the Southerly line of said property to a point; thence North One Hundred Fifty (150) feet on a line parallel with the Westerly boundary line of said property to a point on the Northerly boundary line of said property, thence East Two Hundred (200) feet along the northerly boundary line of said property to the place of beginning, containing Fifty-seven One Hundredths ( $57/100$ ths) of an acre, more or less;



Mr. Smith discussed with the Board the matter of a nominal expense account, advising that he personally paid his traveling, automobile and telephone expense expended on behalf of the company. It was moved by Mr. Stabler, seconded by Mr. Brandt, and carried (Mr. Smith not voting) that Mr. Smith be allowed \$200.00 per month to cover expenditures made by him on behalf of this corporation, same being retroactive to December 15, 1936.

Mr. Stabler advised the Board that the corporation had made a loan of \$1500.00 to 99 Oil Company, evidenced by their ninety day note for \$1500.00 dated December 16, 1937, bearing interest at the rate of 7%.

Mr. Smith submitted an offer to the Board for the purchase from one L. V. Redfield of approximately twelve hundred (1200) units in the Julian #11 Well. It was moved by Mr. Stabler, seconded by Mr. Brandt, and carried that no units in Julian Well #11 be purchased by reason of the fact the Board considers them of no value.

The meeting then adjourned.

H. C. HORSNELL

Secretary

[Endohsed]: U.S.B.T.A. Filed Oct. 4, 1941.

YEARS  
ERSHIPDec. 31,  
1933Dec. 31,  
1934Dec. 31,  
1935

# PETITIONER'S EXHIBIT No. 51

## BARNHART-MORROW CONSOLIDATED

### COMPARATIVE BALANCE SHEET AS AT THE CLOSE AND FOR THE YEARS SHOWN AND DURING WHICH TIME THE COMPANY WAS IN RECEIVERSHIP

#### ASSETS

Details	Dec. 31, 1930	Dec. 31, 1931	Dec. 31, 1932	Dec. 31, 1933	Dec. 31, 1934	Dec. 31, 1935
Cash and Receivables						
Cash .....	\$ 3,361.36					
Notes Receivable .....	350.00	\$ 3,395.61				
Accounts Receivable .....	8,140.90	115.79				
Total Cash and Receivables .....	11,852.26	3,511.40				
Inventories						
Supplies .....	594.09	594.09	\$ 594.09	\$ 594.09	\$ 594.09	\$ 594.09
Deferred Charges						
Prepaid Insurance .....	1,187.05					
Other .....	55.79					
Total .....	1,242.84					
Capital Assets						
Leasehold Interests						
Santa Fe Springs—Wells 1, 2, 3 and 11.....	224,251.92	224,251.92	224,251.92	224,251.92	224,251.92	224,251.92
Long Beach—Hartley Well .....	7,500.00					
Oil Well Machinery and Equipment						
Santa Fe Springs—Wells 1, 2, 3, 11, 16 and 17.....	67,658.89	66,943.96	66,943.96	66,943.96	66,943.96	66,943.96
Long Beach—Hartley Well .....	10,556.45					
Intangible Oil Well Costs						
Santa Fe Springs—Well 16 .....	60,907.12	60,908.31	60,908.31	60,908.31	60,908.31	60,908.31
Long Beach—Hartley Well .....	54,722.57					
Automobiles and Trucks						
Santa Fe Springs .....	7,334.65	7,289.65	7,289.65	7,289.65	7,289.65	7,289.65
Office Furniture and Fixtures .....		811.50	811.50	811.50	811.50	811.50
Total .....	432,931.60	359,393.84	360,205.34	360,205.34	360,205.34	346,983.61
Less—Reserve for Depreciation and Depletion.....	78,368.96	90,283.46	95,845.91	101,658.50	106,820.86	99,979.87
Net Amount Capital Assets.....	354,562.64	269,110.38	264,359.43	258,546.84	263,384.48	247,003.74
Patents .....	1,000.00	1,000.00	1,000.00	1,000.00	1,000.00	1,000.00
Goodwill .....	26,224.21	26,224.21	26,224.21	26,224.21	26,224.21	26,224.21
Other Assets						
Capital Stock issued for Services & Leases.....	219,120.50	219,120.50	219,120.50	219,120.50	219,120.50	219,120.50
Organization Expense .....	42,488.53	42,488.53	42,488.53	42,488.53	42,488.53	42,488.53
Hartley Well No. 1—Salvage .....		50.00	50.00			
Total .....	26,609.03	261,659.03	261,659.03	261,609.03	261,609.03	261,609.03
Accounts Receivable—Collection and realization on which will exceed one year						
C. C. Julian .....	7,104.61	7,104.61	7,104.61	7,104.61	7,104.61	7,104.61
W. J. Barnhart and/or East Santa Fe Springs Escrow Account .....	17,363.15	20,478.25	24,673.29	21,978.09	21,978.09	21,978.09
Sundry Accounts .....	25.00	296.31	296.31	296.31	296.31	296.31
Texas Co.—Gas Revenues Withheld .....			4,193.47	2,928.05	3,372.09	1,609.96
J. A. Smith—Contra against indebtedness due him.....				27.76	1,760.47	4,518.22
Total .....	24,492.76	27,879.17	36,267.68	32,334.82	34,511.57	35,507.19
Grand Total .....	\$681,577.83	\$889,978.28	\$590,104.44	\$580,308.99	\$577,323.38	\$571,938.26

## Petitioner's Exhibit No. 51—(Continued)

## BARNHART-MORROW CONSOLIDATED

COMPARATIVE BALANCE SHEET AS AT THE CLOSE AND FOR THE YEARS  
SHOWN AND DURING WHICH TIME THE COMPANY WAS IN RECEIVERSHIP

	LIABILITIES					
Details	Dec. 31, 1930	Dec. 31, 1931	Dec. 31, 1932	Dec. 31, 1933	Dec. 31, 1934	Dec. 31, 1935
Notes Payable .....	\$ 15,134.15	\$ 4,916.18	\$ 4,137.50	\$ 3,320.70	\$ 3,000.00	\$ 3,000.00
Accounts Payable .....	19,628.34	21,597.37	22,316.68	17,778.11	17,160.43	17,267.70
Accrued Expenses						
Interest .....	282.14	196.67	196.67	796.67	1,096.67	1,396.67
Taxes .....	40.83	820.51	586.64	611.64	780.41	1,051.66
Pay Roll .....	14,931.15	21,078.00	21,078.00	14,078.00	14,078.00	14,078.00
Due to Stockholders .....	7,070.63	6,995.63	6,995.63	6,995.63	6,995.63	6,995.63
Total Liabilities .....	57,087.24	55,604.36	55,611.12	43,580.75	43,111.14	43,789.66
Deferred Credits .....			5,333.25	5,333.25	5,333.25	5,333.25
Capital Stock .....	694,977.00	694,977.00	694,977.00	694,977.00	694,977.00	694,977.00
Surplus—being a deficit .....	70,486.41	160,603.08	165,*16.93	163,582.01	166,098.01	172,161.65
Grand Total .....	\$681,577.83	\$589,978.28	\$590,*04.44	\$580,308.99	\$577,323.38	\$571,938.26

\* Illegible figures.

Exhibit No. 51 Part Two

Geo. F. Meitner &amp; Co., Auditors and Accountants

[Endorsed]: U.S.B.T.A. Filed Oct. 4, 1941.





The Clerk: Mr. Burkhead, do you have a copy of the stipulation of facts?

Mr. Burkhead: Four extra copies in that folder.

The Member: State the case, one of you. What is it about?

Mr. Morton: Inasmuch as I have to be a witness, certain items it might be more proper if Mr. Burkhead would more briefly sketch it. I sketched it the other day without stopping to think about that.

#### Statement of Case on Behalf of Petitioner

Mr. Burkhead: If your Honor please, there are five issues involved in the matter, the first being a salary item which was accrued on the books to a Mr. Hardison for the salary for the year 1931, from January 1st to July 1st of 1931. The salary items accrued in the amount of \$14,000.

In the year 1936 a settlement was reached whereby Mr. Hardison was paid \$7,000, and \$7,000 was written off the books of the corporation and charged to profit and loss. That \$7,000 item is in issue as to whether or not the \$7,000 that was written off was income of Barnhart-Morrow for the year 1936.

The second issue covers a matter of \$16,500.10 which arose in this way: A Mr. Flesher claimed an interest in the [88] proceeds of one of these oil wells involved. Mr. Julian gave Barnhart-Morrow a letter indemnifying Barnhart-Morrow if they paid Mr. Flesher the \$16,500, and it later developed that he was not entitled to the receipt of the money. After the judgment of the court in the case of Julian v. Schwartz it was determined that Mr.

Smith was entitled to that \$16,500. After that judgment became final and in the year 1936 Barnhart-Morrow paid the \$16,000 to Mr. J. A. Smith. We shall offer evidence to the effect that it was not possible for Barnhart-Morrow to recover the \$16,500 already paid to Mr. Flesher. They wrote that off as a bad debt or a business loss in the year 1936.

The third question involved——

The Member (Interrupting): You said paid Mr. Flesher. I thought you said he wasn't entitled to it and they paid it to Smith.

Mr. Burkhead: They had previously paid it to Mr. Flesher in the year 1930 and at that time took a letter of indemnification from C. C. Julian and later had to pay the same amount to Mr. Smith.

The third issue is with reference to the abandonment of Well No. 16. It developed in the year 1937 that that well was costing Barnhart-Morrow more money to operate than they were receiving from it by reason of the fact that Barnhart-Morrow's interest arose out of an operating agreement whereby [89] they operated the well and paid all of the expenses of operating for 50 per cent of the proceeds. Mr. J. A. Smith, the same person to whom the \$16,500 was paid, owned the other 50 per cent of the proceeds from Well No. 16. His share of the operating expense by the terms of that operating agreement under which Barnhart-Morrow produced the well was limited to, I believe, \$250 per month. Since Barnhart-Morrow had to pay Mr. Smith 50 per cent of the proceeds of the well, it was costing them a certain amount to operate the well, they

were losing money, so Well No. 16 was abandoned to Mr. Smith who held the prior leasehold interest.

When Barnhart-Morrow abandoned the well, it reverted to Mr. Smith. That is the fourth question involved, as to whether or not the Barnhart-Morrow Consolidated is entitled to the deduction or that loss from the abandoned Well No. 16

The fifth question is whether or not during the year 1936 during which year up until I believe November 14th of the year 1936, Barnhart-Morrow's assets were in the hands of the receivers and co-trustees under the Julian v. Schwartz litigation. The question involved there is whether or not during that period of time Barnhart-Morrow was insolvent, and there is no question but what they were in the hands of the receiver, but the question is whether or not they were insolvent. [90]

I must have skipped a number, because there are only five issues involved here and I have spoken of five. I don't remember which one I missed

Mr. Tonjes: Depletion.

Mr. Burkhead: That is the question of depletion. That arises in this way, as to whether or not Barnhart-Morrow is entitled to figure depletion upon the amount, the total amount, of oil, and the proceeds received from oil, by the co-trustees while they were operating the properties, or whether or not their depletion is to be based upon the actual amount of cash that the trustees handed over to Barnhart-Morrow in 1936 after the co-trustees had paid all of the operating expenses of the well.

Barnhart-Morrow held an operating agreement

to operate the wells for which they were to pay the expenses of operating the wells and were to get 65 per cent of 70 per cent of the proceeds. That was determined in the judgment of Julian v. Schwartz. When it became final after the expenses of operating the wells had been deducted and the co-trustees paid to Barnhart-Morrow their share of what was left, 65 per cent of 70 per cent, and that depletion question resolved around on which figure we were to take to base depletion.

The Member: Do you have a statement for the respondent?

Mr. Tonjes: There are other issues set forth in the petition, your Honor, and I presume that those are waived. [91]

Mr. Burkhead: That is correct.

#### Statement of Case on Behalf of Respondent

Mr. Tonjes: That leaves five issues as stated by the counsel for petitioner.

I might say briefly what my position is with respect to these several issues.

The Member: First, before you start, you speak about others being waived. I was wondering about that, because there are a large number enumerated here. Are they waived or have some of them been disposed of by your stipulation?

Mr. Burkhead: No. They have been waived. They are small items.

The Member: All right. Go ahead.

Mr. Tonjes: With respect to the first item mentioned by counsel for the petitioner, the claim by the respondent that taxpayer realized \$97,000, that



is based on the fact that the obligation to pay the salary of \$14,000 was cancelled to the extent of \$7,000 and therefore the taxpayer realized taxable income for that extent, it being a solvent corporation at the time.

The second relates to a bad debt or loss claimed by the petitioner. I don't know whether it makes any difference particularly whether he claims it as a bad debt or a loss, although perhaps he should be called upon now to state which position he has taken. The amount is disallowed by the re- [92] spondent as a deduction for the reason that—well, to state it generally, I guess the respondent questions the good faith of the transaction. Mr. Smith was an officer of the corporation, as I understand it, a majority or principal stockholder, and the entire circumstances surrounding the transaction do not constitute such facts which amount to an allowable deduction.

Now, with respect to the depletion item, which is perhaps one of the more important questions of the case, respondent's position there is that when the distributions were made in the years 1936 and 1937 from the trustees to Barnhart-Morrow, the petitioner, upon the termination of the litigation involving the various rates of the parties to the wells which the petitioner was operating, that is, he had an operating agreement, the respondent contends that when those payments were made, that they constitute the petitioner's gross and net income for the purpose of determining depletion; in other words, what the court ultimately ordered to



be paid to the petitioner was a specific amount in cash which was the result of several years', net result of several years' operations of the wells which were covered by the operating agreement; that petitioner never had any constructive possession of the gross income and that when he finally got something, it was net income, and the depletion allowance is limited to that. [93]

The Member: You contend that is what he would have got under Section 114 of the property?

Mr. Tonjes: Yes, your Honor.

Another issue is the abandonment of Well No. 16. That, of course, is perhaps largely factual. We have stipulated that the property was quitclaimed, but there again it was quitclaimed to a stockholder of the organization, Mr. Smith again, and apparently there was no effort made to salvage any property or anything of that sort. It was just given to him, and respondent submits that under the circumstances, why, there is no deductible loss resulting, and if there is a loss at all, it is a capital loss and the capital limitation applies.

The Member: It was claimed as an ordinary loss.

Mr. Tonjes: I think it was, yes, your Honor.

The remaining issue is the question of the solvency of the corporation, and I think that depends largely on whether or not the assets of the corporation, the properties which were used in connection with the operating of the wells, and the other assets which the petitioner ultimately received by reason of the court decision might be deemed to be such assets to take into consideration in determining the

corporation's net worth, that is to say, whether its assets exceeded its liabilities or not. That is, I should say, also rather factual.

The Member: Now, in addition to the evidence already [94] adduced in the form of a stipulation and 55 exhibits, put on the rest of your evidence as to the petitioner.

Let the record show that it is agreed there is no Exhibit No. 13 among the 55 exhibits attached to the stipulation.

Mr. Burkhead: That is correct.

Mr. Tonjes: I don't have any 13. I haven't noticed it before, your Honor.

The Clerk: I checked the stipulation.

The Member: Let the record so show it is agreed.

Put on your evidence.

Mr. Burkhead: Mr. Morton.

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### HAROLD C. MORTON

a witness on behalf of petitioner, was duly sworn and testified as follows:

The Clerk: You will tell the reporter your name, please, Mr. Witness.

The Witness: Harold C. Morton. M-o-r-t-o-n.

The Member: You are taking the stand, Mr. Morton, as an attorney to do some identification?

The Witness: No, your Honor. I was in the position of being a director and participant in some of the proceedings involved here, and in fact it will appear that I made a motion with respect to

(Testimony of Harold C. Morton.)

one of the resolutions involved; hence, of necessity, I have to appear as a witness. That is the reason that any argument I would not personally participate [95] in.

The Member: Go ahead under the circumstances.

#### Direct Examination

Q. (By Mr. Burkhead) Mr. Morton, were you connected with Barnhart-Morrow Consolidated during the year 1936?

A. Yes, sir. I was their counsel, one of their counsel in the year 1936, and at that time a stockholder; that is, the law firm of which I am a member, Byron Hanna and Harold Morton, was a stockholder in the company. My recollection is I was not a director until some time early in 1937. I am a director at the present time.

Q. During the year 1936 did the question of salary owing to a Mr. Hardison, was that discussed by the board or directors in your presence?

A. It was, and I was called upon to negotiate with Mr. Hardison, who was president of the company, in an endeavor to adjust the matter, and did participate in that regard. His salary was a matter which was in dispute, that is, this salary which has been referred to in these proceedings, or, rather, that is referred to in these proceedings.

The Member: That is the \$7,000 item?

The Witness: Yes. It was a larger amount, but it was settled at the \$7,000 figure.

Q. (By Mr. Burkhead) Did you negotiate with

(Testimony of Harold C. Morton.)

Mr. Hardison with reference to a settlement of that claim? [96]

A. I did, and reported to the board my negotiations and the result of them, and the board by a resolution approved the payment of \$7,000 and no more on Mr. Hardison's claim. That occurred, the action of the board occurred, on the 11th of December, 1936.

Q. A copy of that resolution passed by the board of directors has been introduced as an exhibit, if the Court please, and attached to the stipulation.

A. I so understand it. That is the reason I didn't refer to the matter further.

Mr. Burkhead: May I speak to the witness off the record?

The Member: Yes.

(Conference between counsel and the witness.)

Mr. Burkhead: I suggest, if your Honor please, that as we go along with these different items that we complete the record as to each issue involved and then go to the next one, so if counsel wishes to cross examine the witness on this particular point, he can do that.

The Member: Well, that would of course make it rather well cut and definite, but I would think that your cross examination in that way would be rather confusing as a whole. I suggest that you just pass from one issue to the other and opposing counsel may in the same way follow the different issues in this examination.

(Testimony of Harold C. Morton.)

Q. (By Mr. Burkhead) During the year 1936 did the matter [97] of the payment of \$16,500.10 to Mr. J. A. Smith, which amount had theretofore been paid to one Flesher after the receipt of an indemnity letter from C. C. Julian, was that matter presented to the board and discussed by the board of directors?

A. It was, and in my presence. That indemnity agreement, for the sake of the record, is marked Exhibit 39, and pursuant to that indemnity agreement the stipulation shows that there have been paid to Flesher, a transferror of C. C. Julian, an interest in the Well No. 16 in the sum of \$16,500.10, that transfer being made in spite of the matter set forth in Exhibit 38 which was a communication showing that someone else at that time—by “that time” I mean in 1929 or ’30—when the money was started to be paid by Flesher, it was claimed by somebody else. The record shows that in the case of Julian v. Schwartz the court’s final determination was that J. A. Smith owned that interest as successor to the people that had claimed it at the time payment start to Flesher, and Smith then presented——

Mr. Tonjes (Interrupting): I will suggest that the witness refrain from arguing the case. It is a little beyond the scope of the question.

The Witness: I will try to. I am sorry.

Q. (By Mr. Burkhead) The record shows that by stipulation and the copy of the judgment in Julian v. Schwartz which [98] is attached to it as



(Testimony of Harold C. Morton.)

an exhibit J. A. Smith was entitled to receive the proceeds from the interest of which that \$16,500.10 had been **paid**.

Did you have any discretion in your capacity as attorney for Barnhart-Morrow with the board of directors as to whether or not Barnhart-Morrow Consolidated would again have to pay that \$16,500 and would have to pay it to Mr. Smith?

A. Well, the matter was discussed with the board of directors at a meeting held on November 20, 1936, at which time Mr. Smith had presented a statement and a claim for that amount. At that time I reviewed the entire situation with the members of the board of directors and advised them in my opinion of the situation, which was that Mr. Smith was entitled to the funds and they should not have been paid out in any event the way they had been and the court had determined Smith was entitled to that interest and we had no recourse—by “we” I mean Barnhart-Morrow—other than to pay it, and the board on that date adopted a resolution approving the account of Smith, which included this \$16,000 item.

Q. In advising the board that that amount would have to be paid to Mr. Smith, did you also discuss with them the possibility of recovering the amount from either Mr. Julian or Mr. Flesher? [99]

A. Yes. The matter was discussed. As was known to all, Mr. Julian had committed suicide in China and Flesher, his nominee in the matter, knowing this situation was coming up, I had endeavored

(Testimony of Harold C. Morton.)

to locate with the possibility of recovery. Flesher to my own knowledge was one of Julian's associates and at the time Julian and a number of his associates were indicted in the state of Oklahoma Flesher had disappeared and we were unable to locate him or find any trace of him.

Q. Now, directing your attention to the year 1937 and about the month of December with reference to what was known as Well No. 16 in particular, will you state the interest that Barnhart-Morrow Consolidated had in that well and how that interest arose?

A. Well, the documents with respect to that are all marked and identified by the stipulation. If there is no objection to reciting that chain of title for the sake of clarity, I will do so, but I wouldn't want to if Mr. Tonjes at this time thought it might be unnecessary.

Mr. Tonjes: I don't think it is necessary. If you will just make reference to the document, that will be all right. The exhibit will show that, and I think it will be sufficient.

The Witness: Yes.

That well in question, No. 16, was one of a number of [100] wells located on this 10-acre Brunson property at Santa Fe Springs, and under a chain of title Barnhart-Morrow had drilled Well No. 16. The document which Mr. Burkhead just gave the member, 32 I believe—is that the document? Yes, it is. That provided that Barnhart-Morrow should drill the well and reimburse themselves for the cost at a certain amount and then one-half would belong

(Testimony of Harold C. Morton.)

to W. J. Barnhart, W. J. Barnhart in turn was holding that for Julian, and assigned it to a man by the name of Cady, the other half interest. And there is a chain of title here from Cady to Boyle and Cady and Boyle to Smith, being that same half interest which we were talking about a moment ago.

Barnhart-Morrow drilled the well and drew sufficient oil to reimburse their cost. The well had declined in production at the end of 1937 and certain questions arose with respect to it, but at that time the other half interest in the well was owned by J. A. Smith, and, as I believe I stated before, that had been the subject of the judgment in *Julian v. Schwartz*, which is marked in here as one of the exhibits.

Q. (By Mr. Burkhead) Now, during the year 1937 what was the condition of Well No. 16?

A. Well, at December 17, 1937, there was a directors meeting at which that matter was discussed and the fact was developed and pointed out—in fact, I brought the matter up—that we, that the Barnhart-Morrow Consolidated, were operating [101] this Well No. 16 at a loss. It was a small well. We had a half interest in the well only. Under the existing agreements which are marked here, the other half interest could be charged not to exceed \$250 a month for operating expenses. We had operated at a loss for something over a year and I recommended to the board at that time that we quitclaim that well to Smith, to him because he was the one next above us in the chain of title and to whom the title would be

(Testimony of Harold C. Morton.)

quitclaimed if we gave it up and abandoned it. Smith owned the other half. There was discussion on that, and on that date after that discussion there was a resolution adopted, Mr. Smith not voting, that covers the matter. And that resolution has been marked as an exhibit in this case.

The Member: Can you state the number?

The Witness: Yes, I am going to in just a second to make that clear.

The resolution, No. 47, and the quitclaim deed itself I note is marked Exhibit 46. The resolution so marked and which is an exhibit here commences with a recital that the well in question, identifying it, is deemed not profitable and that J. A. Smith is the owner of part title and would accept a quitclaim deed, and then the resolution proceeds to direct that it be quitclaimed.

I would like to explain that at this time, at the time of this quitclaim, I was personally very familiar with the [102] situation in the Santa Fe Springs oil field with respect to such old wells, being the fortunate or unfortunate owner of several such wells myself, and was familiar with the problems confronting such a well as this, and I advised the board at that time that I did not think the company should endeavor to put this well on greater production or to spend any money on it. I knew that Mr. J. A. Smith so advised the board, and so advised the board, had spent considerable money in an endeavor to return to production his well No. 14, which is another well located upon this same Brunson 10

(Testimony of Harold C. Morton.)

acres, and I knew he had spent a great deal of money running into some 60 or 70 thousand dollars endeavoring to return to production a well known at Italo No. 2 which was also located on this Brunson 10 acres.

Those matters were all discussed; that is part of the discussion which was referred to as having occurred in the minutes, which are Exhibit 47.

The Member: Is there any argument about the amount of the loss? I notice that \$43,000 plus is claimed. Is there any argument about the amount?

Mr. Tonjes: There is, your Honor. I don't concede the amount. As a matter of fact, I believe the petitioner claims there is a larger loss.

The Member: The petitioners claim \$143,151.96.

Mr. Tonjes: I think that might be correct. At least the [103] amount is larger than claimed in the original return. We do not concede the amount in any event.

The Witness: Those are figures which I as a witness can not throw light upon, that being a book-keeping matter.

Q. (By Mr. Burkhead) Mr. Morton, was there any change in the status of Barnhart-Morrow Consolidated between the date of January 1, 1936 and about November 14, 1936? A. Yes, there was.

Q. I am speaking from a financial standpoint.

A. Yes.

Q. Will you state the extent of that, as you recall it, if you have the figures?

A. Down to the finality of the judgment in



(Testimony of Harold C. Morton.)

Julian v. Schwartz, after which, and I believe some time in November, Barnhart-Morrow received some moneys which had been impounded in that litigation, Barnhart-Morrow was without funds to pay their obligations or to conduct their affairs.

Q. The change came about by reason of the receipt of the funds from the co-trustee?

A. Yes. After the judgment in Julian v. Schwartz became final, which I think was in the end of October or early November. It appears from the record, of '36.

Q. But prior to the receipt of the money from the co-trustees in November of 1936 and looking backward through the year 1936, the condition of the company from a financial standpoint [104] was about the same as it had been in the years '35 and '34?

Mr. Tonjes. That is objected to as calling for a conclusion, and not the best evidence. The books and records of the corporation are the best evidence.

Mr. Burkhead: That is all.

#### Cross Examination

Q. (By Mr. Tonjes) Mr. Morton, did you know whether or not there had been any resolution passed authorizing a fixed salary to Mr. Hardison at some prior date, that is, a date prior to the time that this compromise was effected?

Mr. Burkhead: I think we stipulated to that.

The Witness: Well, asking for my knowledge, I would say I would not know. The first time that I had any knowledge of Hardison's salary items

(Testimony of Harold C. Morton.)

were when they became involved in the suit of Morrow v. somebody, which is referred to in here, wherein the receiver was appointed for Barnhart-Morrow. In that litigation I know there were claims that there were excessive and fraudulent salaries. That was started in 1931, and included this Hardison salary; but whether that salary had been paid pursuant to a resolution, I cannot at this time recall, or, rather, had been set up pursuant to a resolution, because I understand it wasn't paid.

Q. They were accrued? A. Well——

Q. (Interrupting) On the books. We stipulated that, I be- [105] lieve.

A. If you did, I can't state because, of course, you understand I have never personally examined the books and records of Barnhart-Morrow other than the minute book since I have been interested in the company.

Q. You have no reason to believe, do you, that the salaries were not properly accrued?

A. If you ask my opinion, I am sure they were very improperly accrued. They were perfectly ridiculous and exorbitant salaries. In fact, Hardison conceded the same when I worked out the adjustment with him.

Q. You don't know the circumstances under which they were accrued?

A. Well, I know pretty well, Mr. Tonjes.

Q. Do you?

A. Yes, because it was a case of you pat me on the back and I'll pat you, between a man by the

(Testimony of Harold C. Morton.)

name of W. J. Barnhart and this man Hardison. One was president and the other general manager of the company.

Q. Were they the principal stockholders at that time?

A. They were the principal stockholders, but not majority stockholders.

Q. Not majority?

A. No. Barnhart-Morrow had hundreds of stockholders and their holdings together combined were a majority I am sure. [106] Oh, yes. I am certain of that, and Barnhart was general manager at a salary or purported salary of \$2,000 a month, having been appointed by Hardison after Hardison had been elected president with some such salary set up to him of a certain amount. That lead to the litigation in which a receiver was appointed for Barnhart-Morrow in 1931.

Q. Now, I believe you testified that the Barnhart-Morrow acquired its interest in the properties on which was located Well No. 16 by Mr. Smith?

A. No.

Q. What was the situation?

A. The way that was acquired, if I may state it to you, was with respect to Well 16, in 1928, after the deep sand had been discovered in the Santa Fe Springs oil field the holders of the land out there on this Brunson lease executed what is called the United Lease. That was executed to Barnhart, the same W. J. Barnhart. Barnhart then assigned all of the rights under that lease except with respect

(Testimony of Harold C. Morton.)

to a certain area which is described to Julian. Then on that executed area he made an operating agreement with Barnhart-Morrow that they would drill a well upon that particular area, which well became Well No. 16. His deal with Julian was on that particular area that Barnhart-Morrow would get to drill that well and a half interest after they got it across would belong to Julian, and, that is, the half interest then that Julian sold [107] to Cady and Cady to Boyle and Boyle to Smith and so on. That is the history of how Well 16 was drilled.

The operating agreement under which Barnhart-Morrow drilled that I think was identified a moment ago as Exhibit 32. The other documents which I have referred to in that chain of title, the United Lease, and so forth, are marked in this exhibit, but I don't have the numbers at my fingertips. But my reference with that claim will I think connect with the stipulation.

Q. I will just state that Exhibit 32 says under circumstances which require the operation of the well by natural flow the expenses shall be \$250 a month and when pumping \$500 a month. Does that refresh your recollection?

A. Yes, that is the agreement. Yes, sir.

Q. Now, when the well was quitclaimed, was it producing any oil at all?

A. Yes, it was producing, but not in sufficient amount that Barnhart-Morrow made a profit out of it. I think the records will show when they are presented here; it was my understanding at that

(Testimony of Harold C. Morton.)

time, certainly, and I acted upon that assumption that we were operating at a loss.

Q. You mean it would cost more than \$500 a month to operate the well and you would be reimbursed for no more than \$500?

A. We would only be reimbursed for \$250. We only had a half of it. We had a half of the lessee's interest. We oper- [108] ated the well and we could charge a total operating cost of \$500, which would mean against the other half \$250. And that was not sufficient to operate the well.

Q. Under the terms of the agreement, then, you were required to operate the well whether you made a profit or not, is that right?

A. That is right, as long as we held it. That is the reason we have it up.

Q. Well now, was there any equipment at this well?

A. Yes, there was equipment on the well, of course. There always is equipment on a producing oil well. That equipment presented some problems. In any event, the owner of the other half interest was entitled to half of it because Barnhart-Morrow in drilling the well had been reimbursed for their entitled cost, the entire cost on the premises. Whether Barnhart-Morrow could have insisted upon just stopping the well and saying "We will divide it up, divide up the physical equipment," was discussed at the board of directors.

I said I doubted whether we should do that, whether we should destroy something that might



(Testimony of Harold C. Morton.)

have some value to someone else, and in any event under the terms of the United Lease there were provisions giving the lessors the right when a lessee wanted to abandon to take possession of the entire thing, including the equipment, and under all the [109] circumstances we just decided to wash our hands of the entire matter and turn it over. That was the way the equipment was disposed of. What equipment was there is still on the premises, but we gave up all our right to the matter because there always is some salvage in an oil well, but under the circumstances here, why, we thought it was a matter of policy; at least I urged to the board to abandon the matter and forget about it and take the loss and have it over with.

Q. Have you any idea what the salvage would have been had you attempted to do so?

A. I haven't. It might have been as much as \$2,000.

Q. Now, when that property was quit claimed to Mr. Smith, was there any agreement on his part that he would continue to operate it?

A. No. We left that entirely to him. We had nothing to do with it and quitclaimed and left it. And I want to urge this in view of a question, if I may; I say "urge." A witness shouldn't say that, but I can't resist the expression. That matter was not suggested by Smith. I was the one that brought it up and suggested it to the board that we give up this well because I was rather closely in touch with the activities in Santa Fe Springs and know the

(Testimony of Harold C. Morton.)

situation here, that we were operating this well at a loss.

Q. And did Mr. Smith thereafter operate the well? [110]

A. I understand he did.

Q. And it was profitably operated, wasn't it?

A. He so informed me. He is here. You can question him about it.

Q. Well then, as a broad proposition you would say there were some profits flowing to the Barnhart-Morrow Consolidated by reason of this quitclaim of the well?

A. Well, in the sense we got rid of a property we were losing money on operating.

Q. And which you were bound to operate under the terms under which you held it?

A. As long as we held it, until such time as we quitclaimed it.

Q. Yes. And was Mr. Smith a stockholder at that time?

A. Mr. Smith was a stockholder at that time.

Q. Of Barnhart-Morrow?

A. Of Barnhart-Morrow, and a very substantial stockholder.

Q. Can you state the percentage of interest?

A. I can give it to you approximately. He can give you the exact figures, I believe. I believe Barnhart-Morrow had approximately 690,000 shares of stock outstanding. Smith stockholdings, his own interest in stockholders, was approximately 250,000 shares. I would like to state that I [111] believe

(Testimony of Harold C. Morton.)

Mr. Hanna's and my shares are some 63 or 64 thousand shares, and were at that time. There were a great many stockholders who held the balance of the stock.

Q. Did Mr. Smith partake in the discussion as to the advisability of the abandonment by the corporation?

A. No, he refrained from it. I asked him questions about what he had spent on his No. 14 well and on his Italo well which I knew he had worked unsuccessfully prior to this time.

Mr. Tonjes: I think that is all.

Mr. Burkhead: That is all.

The Witness: There has been no question asked, your Honor, but I would like to state that as far as I know, no other stockholder of Barnhart-Morrow has any interest of any kind in Smith's operations in that well after it was quitclaimed to him. I had none and Mr. Hanna had none and I know of no other stockholder having any interest.

(Witness excused.)

The Member: Call your next witness.

Mr. Burkhead: Mr. Smith.

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### J. A. SMITH

a witness on behalf of petitioner, was duly sworn and testified as follows:

The Clerk: You will take the stand and give your name.

(Testimony of J. A. Smith.)

The Witness: J. A. Smith. [112]

Mr. Burkhead: If the Court please, we agreed to produce Mr. Smith for the benefit of Government counsel. He is the gentleman who has been waiting all week to get this matter through with and we would like to call him and let counsel examine him, if he wishes.

Direct Examination

Q. (By Mr. Tonjes) Mr. Smith, how many shares of stock did you own in Barnhart-Morrow Company late in the year 1936?

A. May I refresh my memory from a memorandum that I had made up for that?

Q. Surely. You had it made up recently?

A. Yes, in the last day or two, as of the end of 1937.

Q. '36? Or '37, I should say.

A. '37. That is right. There appeared on the records of the company to be 290,476 shares in my name. Of that amount, 189,120-1/2 shares are what are termed escrow shares. They are shares that have never been released and are tied up by reason of the Commissioner of Corporation's order, and of that amount, of that 189,120 shares, Mr. Hanna and Mr. Morton owned 37,824 shares.

Do I make myself clear?

Q. Yes.

A. So that I owned of the escrowed shares 151,296, which would give me a total of approximately 250,000 shares, even though 290 appear of record

(Testimony of J. A. Smith.)

as mine. The exact number— [113] pardon me. The exact number is 252,632-1/2 shares.

Q. Now, when this well was abandoned—strike that.

When the No. 16 was quitclaimed by Barnhart-Morrow, did you immediately start to manage the well? A. Yes, I did, sir.

Q. What did you do?

A. Well, I had the men at the field try to pull the tubing and clean the well out. In that connection, and for your benefit and better understanding of the situation, let me say this, that about that time the sand, the Meyer sand out of which this well was producing, was giving a lot of trouble in that end of the field, with the result that for a year past and during that time liners were collapsing, and the total amount of oil that had been taken out of the sand had so depleted it that it was shifting under the ground. And I had two wells, one on the east of this and one on the west of this, both of which had collapsed liners in them, previous to this latter part of 1937. And this well had ceased producing and had sanded out and we couldn't pump it or anything of that sort.

Q. That was when it was owned by Barnhart-Morrow? A. Yes, sir.

Q. You also supervised its operation at that time?

A. Yes, sir. In fact, I have been supervising these wells since about 1932, first as a co-trustee and receiver, and sub- [114] sequently after the prop-



(Testimony of J. A. Smith.)

erty was turned back to the Barnhart-Morrow Company I operated as the general manager of the Barnhart-Morrow Company their wells and my own wells. I have other wells on the same premises. And we finally got the tubing and the rods out of the well, ran mangroves or swedges into the well and found that the liner had crumpled, but not totally collapsed. We swedged it out, which luckily was a very simple job. I think a matter of a day or two of swedging we had the liner in shape and it stood since then. It hasn't collapsed since, so the total amount of expense and physical effort in reconditioning the liner at that time was not serious; but it did cost in labor and materials some seven or eight hundred dollars at that time.

Q. That was while the property was yours?

A. That was after it was mine.

Q. After it was yours? A. Yes, sir.

Q. Now, right prior to the time that the property was quitclaimed to you, had the well been operated much? Was the well operating?

A. Yes, sir.

Q. And was it your idea that the well could be continued in operation?

A. You can't have an idea about that. It is just a guess. [115] Let me say that about a year prior or more, maybe a year and a half prior to the end of 1937, and while the well was in the hands of myself as a trustee in the Superior Court, this well's liner collapsed and we spent as trustees something like 18 or 20 thousand dollars to do the same thing

(Testimony of J. A. Smith.)

that I happened to do in the end of 1937 with a very small amount of money.

Q. As the manager and actual operator of the well No. 16, did any of the directors of Barnhart-Morrow or other officers inquire of you as to the advisability of the continuance of its operation?

A. Oh, yes.

Q. What was your advise to them?

A. I told them that was something we couldn't tell until we got into it, which was correct as I understood it.

Q. And was it on that indefinite advice, if you understand what I mean, that Barnhart-Morrow quitclaimed the well to you?

A. Well, I can't say on what basis they quitclaimed. I can say this, that Mr. Hardison is one of the oldest oil operators in the state of California, the president of this thing. Mr. Morton is is an oil operator in his own right, and the other men on the board are practical oil men that have operated in that vicinity.

Q. Did you make any definite recommendation with respect to [116] its continuance?

A. No, sir.

Q. Were you asked?

A. Yes, sir. We discussed the physical condition of the well and their largest concern was the fact that the well might require the expenditure of a large amount of money, and if it did, it would come out of their pocket. They had no way

(Testimony of J. A. Smith.)

of charging me. And they wanted me to take it over for that reason.

Q. Did you as a stockholder—were you also a director of Barnhart-Morrow? A. Yes, sir.

Q. And as a director did you know that under the terms of the operating agreement that Barnhart-Morrow was bound to operate the well?

A. They were bound to as long as they chose to.

Q. As long as they chose to?

A. Yes. They weren't bound beyond that point. They had the right, as I understand it, to quitclaim the well at any point.

Q. And how soon after the well was quitclaimed to you did you proceed to take action to correct the defect in the well's operating facilities?

A. I don't think I understand it.

Will you read the question? [117]

(The question referred to was read by the reporter, as set forth above.)

The Witness: Well, practically immediately.

Q. (By Mr. Tonjes) Immediately?

A. Yes.

Q. And that resulted in a profitable production of oil?

A. Well, in a very minor sort of way, yes, sir.

Q. What do you mean by that? Can you give me some figures on that? A. Yes, I can.

As a result of that we sold in January \$1500 worth of oil and gas approximately, and in February \$1500 worth and in March \$100 worth and in April \$2550

(Testimony of J. A. Smith.)

worth, in May, \$1,464 worth, and \$113 worth of gas, January \$1300, July \$1500. You want just approximate figures?

Q. Yes.

A. I am having difficulty reading these small figures.

And in September, \$1500; October, \$1300; November, \$1200; December, \$1300.

Q. That is fine.

A. It has been going down until now it is doing around seven or eight hundred. That is gross figures.

Q. Was that your share of the property?

A. No. My understanding is that that is gross figures, royalties and thinks like that are to be taken out. [118]

Q. As I understand it, when Barnhart-Morrow inquired of you as to the prospects of bringing the well into a profitable operating condition, you were unable to give a definite opinion?

A. Yes, sir.

Q. But on the other hand you turned right around and invested your own money in it and with an attempt to—

A. (Interrupting) That is right.

Q. Can you explain that? It appears to me to be a little bit inconsistent.

A. Maybe it does, but it isn't inconsistent to an oil man. When a well that has produced oil stops producing, that is the only thing you can do, is to

(Testimony of J. A. Smith.)

start to work on it. You don't know what is wrong with it even until you have worked on it. You can't on the other hand leave it there because of the state laws. The well has to be abandoned if you don't propose to recondition it and don't propose to produce it, and in connection with abandoning a well the cost of getting the well in condition to abandon might go from five to six thousand to ten thousand dollars. You don't know about that. And as I saw it, Barnhart-Morrow as a matter of fact shirked the liability of abandoning the well by turning it over to me. And yet they had the right to abandon it at any time they wanted to. When I say "abandon" it, I mean leave it. [119]

Q. Well then, under the method of operation of oil wells in the state of California, when a well is abandoned, it is likely to entail quite an expenditure of money? A. It may, yes, sir.

Q. And by the acceptance by you of the quitclaim, why, Barnhart-Morrow was relieved of any possibility of incurring any such liability, was it not? A. That is true.

Q. And would you say that was one of the things which motivated the transaction?

A. Well, I suppose that it did. I suppose that it was one of the factors that they took into consideration.

Q. Now, we are going now, Mr. Smith, to another subject. I don't know if you are familiar with it. This relates to that \$16,500 item. In the year 1936, shortly after the termination of the litiga-



(Testimony of J. A. Smith.)

tion, you presented a claim to Barnhart-Morrow Company, did you?      A. Yes, sir.

Q. And that was in the sum of what amount, do you recall? Was the amount approximately \$22,000?

A. I think it was something like that.

Q. And included in that was an item of \$16,500.10, is that correct?      A. Yes, sir.

Q. Now, were you a director of Barnhart-Morrow in 1930 and [120] 1931?

A. No, sir.

Q. Were you a stockholder then?

A. No, sir.

Q. You were not associated with the company at all at that time?

A. No, sir, in no way at all.

Q. And when did you become a stockholder?

A. I am going to have to guess at that, because I honestly do not know. Mr. Meitner could probably help us with the books and records, but I think in 1930 or '33. It was during the course of the litigation in which the properties were involved and during the course of the litigation involving the Barnhart-Morrow Company as a separate lawsuit entitled *Morrow v. Barnhart and Company*.

Q. Yes.

Do you know when you became or recall when you became a director?

A. I didn't become a director until—no, sir, I don't know whether I became a director shortly after buying the stock or some time after buying

(Testimony of J. A. Smith.)

the stock, but it was during the time that the company was in receivership.

Q. The item in question, the sum of \$16,500.10 was set up as a demand by you on account of an acquisition of an interest of one Boyle? Is that correct? [121]

A. Yes, that is correct. It was Cady. I think it was Boyle technically but Cady.

Q. We will call it the Cady-Boyle interest.

You acquired the Cady-Boyle interest in that particular well?

A. Yes. I bought it at a bank in Pasadena. I did not deal with Mr. Cady in connection with that.

Q. When did you buy it?

A. I bought it——

Q. (Interrupting) When did you buy it?

A. I think the name of the bank was the Security Bank.

Q. Do you know when?

A. Pardon me. No. I didn't. It was in the same interval, approximately somewhere between '33 and '34, somewhere in there. Yes, '33 or '34. I am not sure.

Q. At that time did you know anything about the payment of the sum to Flesher?

A. No. I understood the account to be an account receivable of the Barnhart-Morrow Company and still due and payable. That was the way it was represented to me.

Q. Where did you find out about the question—when did you first discover that there had been

(Testimony of J. A. Smith.)

a payment made which represented a portion of the interest you had acquired?

A. Well, it was after acquiring it and I would say perhaps quite some time after I acquired it because the Barnhart- [122] Morrow Company itself and its books and records were in the hands of the receiver in the Superior Court, and while it is true I had some access to them in the sense that I could go talk to the receiver, we didn't discover, as far as I recall, we didn't discover that the payment of this money had been made until we actually got control of the books to the point where an audit was available and that audit was made by Mr. Meitner who was appointed by the Superior Court to audit the books of the Barnhart-Morrow Company. And I don't know when the audit was available. It was after a long period of time and it is difficult to say.

Q. Did you immediately advise Barnhart-Morrow of your acquisition of this interest at the time you acquired it?

A. I am certain in my own mind, and yet if you asked me for the argument, I am certain I couldn't produce it—it was in receivership. I am certain of that. I made certain demands on him so his records would be clear.

Mr. Tonjes: I think that is all of the questions of Mr. Smith.

The Witness: May I ask this: I have been trying to do some other business——

Mr. Burkhead (Interrupting): Just a minute.

The Witness: Pardon me.

(Testimony of J. A. Smith.)

Mr. Tonjes: We will agree, your Honor, that the assignment of the Cady and Boyle interest to Mr. Smith was in 1931; [123] that fact is stipulated.

Mr. Morton: Yes. Exhibit 35.

### Cross Examination

Q. (By Mr. Burkhead) Mr. Smith, after Well 16 was quitclaimed to you and you took it over, did any stockholder of Barnhart-Morrow Consolidated have any interest in that well with you, any interest at all? A. No, sir.

Q. Never have had? A. No.

Q. Did Barnhart-Morrow Consolidated have any further interest or claim any further interest after that quitclaim? A. No, sir, none whatever.

Mr. Burkhead: That is all.

The Member: Mr. Smith, let me ask you a question or two to clear my mind up a bit.

First as to the well, what was the first thing you did to recondition this well after you took it over?

The Witness: Well, sir, I pulled the tubing and the rods after considerable difficulty and that difficulty was due to the fact that the casing—not the casing, but the liner, which is a perforated section of casing—had collapsed sufficiently so as to pack the sand tightly about the tubing. And I succeeded in getting the tubing out. That is the job or that is the problem. And then swedged it with [124] tools so as to bring it back to its original size.

The Member: You ran something down through it and washed it out?

(Testimony of J. A. Smith.)

The Witness: Yes, that is something that might take place with a certain amount of work and stay in place, or to my own experience and in my own experience that is something that might not work at all. In other words, you might swedge it out and as soon as you put the well on production it might not only collapse to the same degree that it had collapsed previously, but might collapse totally.

The Member: The first thing you wanted to know was what was the situation down there?

The Witness: That is true.

The Member: How much expense did that entail in finding that out?

The Witness: Practically all I spent on it. In other words the repair work in this instance was lucky, because it was one that stood rather than stood temporarily.

The Member: What I am wondering is, it occurred to me just a bit queer that the company of Barnhart-Morrow didn't make some investigation to find out what the condition was. Now, clear that up, if you can.

The Witness: They were operating the well at a loss anyhow. As a matter of fact, for the year, they were operating the well for my benefit as a matter of fact. They were get- [125] ting no return out of it. And now they were confronted with spending a hundred dollars, a thousand dollars, or some amount of money, that was indefinite, assuming that they could repair it for \$500 or less than



(Testimony of J. A. Smith.)

I did. They still couldn't make any money out of the well. They couldn't make any money out of the production I got out of it. It would still be a loss to them.

The Member: It occurred to me to wonder why they had not made some investigatory activities.

The Witness: May I add this: this field and this zone was as of that time and now even more so a depleted sand to a point where you know that the production is but a small amount of production.

The Member: So much for that.

How did you come to buy this \$23,000 plus items receivable out of which the \$16,000 was taken that you required from this Pasadena bank?

The Witness: At that I was buying any claim against this property. I mean any claim that appeared to be an interest in the production of the oil to be obtained from this property, and Mr. Cady had this claim and this was but one interest that he had. I mean this \$16,000 account. In fact, I acquired my half interest in the well 16, an interest in the well 17, and the account receivable from Mr. Cady.

The Member: What investigation, if any, did you make [126] before you bought these items such as this one, what they were worth? In other words, I am wondering whether you purchased this without investigation as to whether some portion of it had been already paid. I have these doubts in my mind and I am giving you a chance to clear them up.

The Witness: I can't say that I made an investigation as to whether or not the \$16,000 was due. I

(Testimony of J. A. Smith.)

was acquiring a half interest in Well No. 16 and I was acquiring—I would say a half interest; it is a half of the operator's interest, not a half net—and I was acquiring an interest in Well 17.

The Member: You mean you bought those all as one item?

The Witness: Yes, sir.

The Member: Those matters together as one item, they totalled about \$22,000?

The Witness: No. I didn't pay that much for it. I presented a claim to Barnhart-Morrow Company for 22 or 23 thousand dollars. I don't know the exact amount of it, but that represented other moneys advanced.

The Member: Did you have any reason at the time you purchased these items to question whether the \$16,000 item was payable or would be paid or any doubt about the title to your right to it, so to speak?

The Witness: Well, as I say, I can't say that I made an investigation as to whether it had been paid. It just didn't [127] occur to me that it would have been paid, in the first place; and I bought the three things together. I mean the two interests in the wells and the accounts receivable. That is the way I dealt with it.

The Member: That is all.

Mr. Burkhead: May I inject at this time—I thing it will help the record—that the Cady assignment he is talking about is Exhibit 35(a) and the demand that he referred to is Exhibit 45(a). It

(Testimony of J. A. Smith.)

might help the Court when he reads the testimony.

The Member: Yes. It will. That is all.

The Witness: Is there any possibility that I may be needed any further?

Mr. Tonjes: Not on my behalf.

The Witness: I will be very glad to come back; if not, I would like to be excused.

Mr. Burkhead: You may be excused.

The Member: You may be excused for the rest of the time.

The Witness: Thank you, sir.

(Witness excused.)

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### GEORGE F. MEITNER

a witness on behalf of petitioner, was duly sworn and testified as follows:

The Clerk: You will tell us your name, please, Mr. [128] Witness.

The Witness: George F. Meitner; M-e-i-t-n-e-r.

Mr. Morton: Your Honor, inasmuch as I won't participate further in the matter, and counsel, unless you or Mr. Tonjes thought you might want me as a witness, I would prefer to withdraw.

The Member: I don't know of any reason why you should stay.

Mr. Morton: If there is any question you would like to ask me about anything, I will be glad to remain.

(Testimony of George F. Meitner.)

Mr. Tonjes: I don't think so.

The Member: Very well. You are excused.

We will recess for five minutes at this time before we start with this witness.

(At this point a short recess was taken, after which proceedings were resumed as follows:)

Direct Examination

Q. (By Mr. Burkhead) Mr. Meitner, what is your occupation or business?

A. Certified public account.

Q. Did you act as auditor for the Barnhart-Morrow matters? A. I do.

Q. When were you first engaged in that work for them?

A. I was first appointed by the Superior Court of the County of Los Angeles, State of California, in the matter of D. R. [129] Morrow v. Barnhart-Morrow Consolidated and others in September 1931, I believe, if my memory serves me correctly.

Q. You were acting in the capacity of an auditor for the receiver in that particular matter?

A. I was.

Q. After that time did you make any reports for the receiver or act as auditor for the receiver in the matter of Julian v. Schwartz?

A. I did.

Q. I see.

I will state for the purpose of the record, at this point, that those two audit reports have been referred to in the stipulation and are attached as

(Testimony of George F. Meitner.)

exhibits in the stipulation heretofore filed, one having been dated in February of 1937, and the other in September of 1937.

The Member: Can you name the exhibit numbers without too much looking it up? That will help, if you can.

Mr. Burkhead: I can get them right here, if the Court please.

The audit report of February of 1937 is Exhibit No. 48, and the one of September 1937 is Exhibit No. 49(a).

Q. Mr. Meitner, are you thoroughly familiar with the books and records of the receiver and co-trustees that were kept for the Barnhart-Morrow Company, and other books of the Barnhart-Morrow Consolidated? [130]

A. I am.

Q. You spent considerable time in going over those books through the various years?

A. I have.

Q. The audit reports that you have prepared and referred to as Exhibits 18 and 49(a) were prepared by you from those books?

A. They were.

Q. And the various statements that you may perhaps have re-referred to in the balance of your testimony were prepared by you from the books of Barnhart-Morrow Consolidated, the co-trustees and receivers? A. That is right.

Q. Do you have the originals of those books here in court? A. I have.



(Testimony of George F. Meitner.)

Q. Now, with reference to the \$7,000 item, the salary item of Mr. Hardison, that is, the accrued payroll item of \$14,000, which was, may I say, settled by the petitioner herein by paying to Mr. Hardison \$7,000, and not paying the other \$7,000, will you state just how the \$7,000 item that was not paid to Mr. Hardison was handled and shown on the books of the corporation?

A. Well, at the time I made the audit for the receiver in Barnhart-Morrow Consolidated—

Mr. Tonjes (Interrupting): One suggestion I might make, [131] you Honor. We have here a receiver and a trustee and a corporation. I think that it might make the record clearer if this witness refers to the books of which particular one of those three he has reference to when he answers questions, and the questions the same way.

The Member: It would be helpful no doubt if you can.

Mr. Burkhead: Very well. I will try to do that.

Q. Let's get that book situation straightened out right now, Mr. Meitner.

Were there more than one set of books or were there all the same set of books but in the charge of different persons at different times?

A. Well, there are two separate sets of books involved. There is Barnhart-Morrow Consolidated, a corporation, and its separate set of books, and then the separate books of C. L. Olson and J. A. Smith as co-trustees in the matter of Julian v. Schwartz.

(Testimony of George F. Meitner.)

Q. Then, reframing my question with reference to the \$7,000 item, Mr. Hardison's salary, that item would be reflected on the books of Barnhart-Morrow Consolidated, is that correct?

A. That is correct.

Q. Now, will you state in what way that was reflected and how it was handled from a bookkeeping standpoint?

A. At the time I made the audit for Ralph S. Armour, A-r-m-o-u-r, receiver for Barnhart-Morrow Consolidated in the [132] matter of D. R. Morrow v. Barnhart-Morrow Consolidated, there was accrued on the books of Barnhart-Morrow Consolidated to July 31, 1931, salary in the amount of \$14,000. That remained set up on the books of the corporation until December 1936 when \$7,000 was paid to Mr. Hardison and the balance of the \$14,000 which had been set up as an accrual was cancelled by myself through a journal entry on the books and \$7,000 was credited to surplus. At that time the books actually in fact show a deficit.

Q. In other words, through a journal entry you credited the \$7,000 liability cancelled to surplus, did you not?

A. That is right.

Q. As of what year did you cancel the \$7,000?

A. In 1936 I made the entry.

Q. As of that year?

A. Well, I believe the entry refers to a retroactive cancellation.

Q. To what year?

A. To the year 1931.

(Testimony of George F. Meitner.)

Q. From your knowledge of the books of the corporation and the financial affairs of that company, did the corporation derive any benefit from that cancellation for the year 1931?

Mr. Tonjes: That is objected to, your Honor.

The Member: Upon what ground?

Mr. Tonjes: On the ground that it calls for a conclusion [133] of the witness, that as to whether or not the corporation obtained any benefit is something that rests with the Board's determination, the Board's judgment, and not this witness'.

The Member: It seems to me that that objection is well taken. It calls for a conclusion on the part of this witness. Objection sustained.

Q. (By Mr. Burkhead) Mr. Meitner, do you know from your knowledge of the books of the Barnhart-Morrow Consolidated whether or not that company sustained a loss for the year 1931?

A. They sustained a loss somewhere in the sum of \$90,000 for the year. I believe the amount is set forth in the stipulation of facts.

Mr. Tonjes: That is stipulated, your Honor.

Q. (By Mr. Burkhead) Now, with reference to the \$16,500.10 that has been talked of heretofore as having been first paid to Mr. Flesher and later paid to Mr. Smith following the judgment in Julian v. Schwartz, how was that item \$16,500.10 handled on the books of the corporation from a bookkeeping standpoint? Will you trace those entries that you made?

(Testimony of George F. Meitner.)

A. Well, the sum of some \$22,000 which was paid to Mr. J. A. Smith I believe in November of 1936 was charged to accrued royalties. In that account there had been accrued prior to that time a balance of royalties that had accumulated from the production of Julian Well No. 16 prior to the time that such [134] well was involved in the litigation of Julian v. Schwartz. In view of the fact that there had been theretofore paid to Flesher, in fact, in the year 1930 there was paid to H. B. Flesher, the sum of \$16,500.00, and since there was not sufficient accruals in the royalty accrual account to cover the amount which was paid to J. A. Smith, I made an entry crediting royalties accruable for the sum of \$16,500.10 and charged it off to miscellaneous losses, which account in turn was charged off to profit and loss in the year 1936.

Mr. Burkhead: Handing counsel a copy, I offer in evidence as Petitioner's Exhibit 56 a certified copy of the stipulation for dismissal of receiver and agreement regarding operation of wells and impounding of funds pendente lite in the case of Julian v. Schwartz in the Superior Court of the State of California, No. 315-345. The only purpose of offering this is to show that in that stipulation and order it was provided that separate accounts of production and expenses of operation of each of said wells shall be kept.

Mr. Tonjes: No objection.

The Member: This will be No. 56.

The Clerk: That is correct, your Honor.

(Testimony of George F. Meitner.)

The Member: Admitted in evidence as Petitioner's Exhibit No. 56. [135]

(The said stipulation, so offered and received in evidence, was marked Petitioner's Exhibit 56, and made a part of this record.)

Q. (By Mr. Burkhead): Now, Mr. Meitner, were separate accounts made of each and every well in which Barnhart-Morrow had an interest and which were involved in this litigation?

A. You are referring now to the receiver's records, the trustee's records of Olson and Smith?

Q. That is correct.

A. The bookkeeper keeping the records for C. L. Olson and J. A. Smith, co-trustees in the matter of Julian v. Schwartz involving Julian Wells 1, 2, 3, 11, 16, and 17, gets the income or proceeds from the production of oil separately by wells and also kept the expenses of operating such wells separately by wells.

Q. I show you a document entitled "Barnhart-Morrow Consolidated gross income expense, depletion, net income" for the year ended December 31, 1937, and I will ask you if you will examine it.

A. (Examining document): I prepared this statement, this document.

Q. From what did you prepare it?

A. From the books of the company.

Q. In your opinion is it a true reflection of the books of the corporation, of the company?

A. This statement here reflects the income and



(Testimony of George F. Meitner.)

expenses of the [136] company for the year 1937, taking into consideration such minor items——

Mr. Tonjes (Interrupting): I object to the witness describing the document which is not in evidence, your Honor.

Mr. Burkhead: I am trying to lay a foundation to get it into evidence, your Honor.

Q. Does that document show the income and expenses, operating expenses, with respect to each well separately for the year 1937?

A. It does.

Q. You took those figures and prepared that document from the original records of the company?

A. I did.

Mr. Burkhead: I offer that as Petitioner's Exhibit No. 57, if the Court please. A copy has been presented to counsel.

Mr. Tonjes: The respondent *rejects* to the offer, your Honor, for the reason that it goes further in that it sets forth additional matters to those stated by the witness. It attempts to show what is a proper depletion allowance and respondent objects to it for that reason. I think that if the offer or the document is revised so as to——

Mr. Burkhead (Interrupting): I withdraw that. That is not the purpose I had in mind at all. I withdrew the offer of the exhibit and will go at it in this way: [137]

Q. Mr. Meitner, can you state the income that Barnhart-Morrow received from Well No. 16 during the year 1937?

(Testimony of George F. Meitner.)

A. The total gross income reflected on the records is \$10,349.87 from proceeds from their operation of Well 16 during the year 1937.

Mr. Tonjes: May I confer with counsel for a moment, your Honor?

(Conference between counsel.)

Q. (By Mr. Burkhead): From the proceeds of the oil Barnhart-Morrow received from Well No. 16 we paid out a certain amount of royalty interest to the third party, is that correct?

A. That is right.

Q. And what was the amount of that?

A. \$2,885.14.

Q. That would leave the net amount of oil and gas revenue from Well No. 16 to Barnhart-Morrow Consolidated for the year 1937 as \$7,464.73, is that correct?

A. That is correct.

Q. What was the amount of the well operating expenses as to Well No. 16 for the year 1937?

A. Operating costs and maintenance was \$6,134.73.

Q. What other expenses did Barnhart-Morrow pay for that Well 16 for the year 1937?

A. There was general field overhead expense of the Santa [138] Fe Springs field which involved Julian Wells 1, 2, 3, 11, 16, and 17, of which the proportion charged to Well 16 was \$1,536. The proportion of general administrative expense which was charged to Well 16 was \$1,503.14. Mining rights, taxes, State Oil and Gas fund taxes, and personal

(Testimony of George F. Meitner.)

property taxes which were paid out for Well No. 16 is \$468.10.

Then a loss sustained on tubing collapse on Well 16 in the year 1937 amounts to \$1,081.54.

Mr. Tonjes: If your Honor please, in the interest of saving the Court's time, might I state that the document offered by counsel for the petitioner sets forth the operating result of several wells and counsel is evidently going to go down the line and show all of these figures.

Mr. Burkhead: I am through right now.

Q. That makes a total of \$10,723.51 overall operating cost as to well 16 for the year 1937?

A. That is correct.

Q. Which leaves a net operating loss before deductions for depletion allowance in the amount of \$3,258.78, is that correct?

A. That is correct.

Q. That was the condition of the Well No. 16 as of about December 20, 1937, is that correct?

A. That is the operating loss to that date.

The Member: What is the date when Smith took it over? [139]

The Witness: I think it was quitclaimed on December 20th and this takes all expenses of operation down to that date. I think the well went off of production on December 17th.

Q. (By Mr. Burkhead): May I ask the witness to point out to me the statement which I think you have prepared showing that \$42,000 item that is claimed as a loss on that well?

(Testimony of George F. Meitner.)

A. On the same statement.

Q. Can you state briefly how the figure of \$43,151.96 claimed as a loss on Well 16 was arrived at and established?

Mr. Tonjes: Claimed as a loss on what?

Mr. Burkhead: On the abandonment of Well 16.

Mr. Tonjes: In the petition?

Mr. Burkhead: That is right.

The Witness: Well, from the books of the corporation I prepared this agreement—this exhibit, showing tangible well equipment of \$26,890.37, less the cost of casing and tubing collapse at March 1937 of \$5,959.12, making the net original return for well equipment cost as set up on the records \$20,931.25.

Q. (By Mr. Burkhead): Maybe I can shorten this. Is this tabulation that I hand you now, does it reflect the figures and the manner in which you arrived at that figure, total figure of \$43,151.96?

A. It does.

Q. And the figures appearing on this statement, did you take [140] those from the books of Barnhart-Morrow Consolidated? A. I did.

Mr. Tonjes: Might I ask the witness a question or two?

Mr. Burkhead: Yes.

Mr. Tonjes: Mr. Meitner, in determining this figure of \$43,151.96, you obtain all these figures from the books of Barnhart-Morrow?

The Witness: Yes, I believe I have got all the figures set up there at the time I made the audit.

(Testimony of George F. Meitner.)

Mr. Tonjes: Did some of the figures come from the books of the trustee?

The Witness: No, they didn't.

Mr. Tonjes: You state that there has been claimed a deduction for depletion on December 31, 1935, in the amount of \$28,472.01. Where did you get that figure?

The Witness: That is on the books of the corporation.

Mr. Tonjes: What does it represent?

The Witness: It is depletion that had been accrued on production in prior years up to December 31, 1935, referring to that \$28,472.01.

Mr. Tonjes: That depletion represents depletion during the period in which the trustees operated the wells?

The Witness: No. That practically represents the depletion up to the time that the wells were taken over by the trustees. In other words, it is in the early years of pro- [141] duction of Well No. 16.

Mr. Tonjes: That is depletion sustained prior to the time the trustees took over the operations of the wells?

The Witness: That is correct.

Mr. Tonjes: And do you know whether or not that corresponds with the depletion figure deducted from the income tax return for this corresponding period?

The Witness: Yes, I do.

Mr. Tonjes: Did you check that?



(Testimony of George F. Meitner.)

The Witness: Yes, I did. In other words, in my conferences back in Washington it may be that this might have a little depletion with respect to gas production of well—no, because Well 16 wasn't involved in that. This is all prior to the time the receivers took over the operation of that well.

Mr. Tonjes: And the two figures immediately following, depletion on Olson and Smith distribution of 1936 of \$9400 and eight thousand odd dollars, how did you ascertain that figure?

The Witness: Those were calculated by me on the amount of gross proceeds of the oil which had been credited the Barnhart-Morrow by Olson and Smith in the report that I prepared for that receivership.

Mr. Tonjes: In other words, that represents depletion?

The Witness: As I calculated it. [142]

Mr. Tonjes: For a period during which Barnhart-Morrow did operate the wells?

The Witness: That is right.

Mr. Tonjes: I have no further questions.

Mr. Burkhead: I will offer this document as Petitioner's Exhibit 56, for the purpose of showing the method and the manner in which petitioner arrived at the figure \$43,151.96 which the petitioner has claimed to have sustained as a loss on Well No. 16 at the time it was abandoned in 1937 and not for the purpose of showing that it is evidence of the fact that they did sustain that, but to show how we arrived at that figure, to show our method of computing.

(Testimony of George F. Meitner.)

Mr. Tonjes: It is objected to in the form offered as being immaterial.

The Member: The objection is overruled. It may not be highly material, but it occurs to me that for that purpose it may be helpful.

Now, Mr. Clerk, what is your number? The last number was not used.

The Clerk: If your Honor please, No. 56 was the last one which was admitted in evidence.

The Member: 57 was referred to, but not offered.

Mr. Burkhead: I withdraw the offer.

The Member: Not even identified.

This will be No. 57. Admitted in evidence as Petitioner's [143] Exhibit No. 57 for the purpose stated by counsel.

(The said document, so offered and received in evidence, was marked Petitioner's Exhibit No. 57, and made a part of this record.)

(Testimony of George F. Meitner.)

## PETITIONER'S EXHIBIT No. 57

## BARNHART-MORROW CONSOLIDATED

LOSS ON OIL WELLS QUIT CLAIMED AND/OR  
ABANDONED IN YEAR 1937

## JULIAN WELL No. 16

Tangible Well Equipment .....	\$ 26,890.37
Less—Casing and tubing collapse March 1937.....	5,959.12

Net original tangible well equipment cost.....	\$ 20,931.25
Casing and tubing replacement June 1937.....	9,534.26
Oil Tanks .....	1,300.00
Engines .....	1,038.72

Total Tangible Equipment .....	32,804.23
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Less:

Depreciation provided—Total .....	22,767.06
Deduct: Depreciation on casing and tubing collapse.....	4,877.58

Net Depreciation Reserve 12-20-37.....	17,889.48
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Depreciated Cost of Tangible Equipment.....	\$ 14,914.75
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(Testimony of George F. Meitner.)

## Petitioner's Exhibit No. 57—(Continued)

Intangible Drilling Cost		
Labor .....	22,818.89	
Hauling .....	2,443.01	
Fuel, Power & Water .....	2,632.56	
Repair Materials .....	3,411.31	
Supplies .....	22,559.79	
Tool & Equipment Rental .....	7,920.69	
Miscellaneous .....	4,878.50	
Drilling Tools Expense .....	3,898.30	
Depreciation on Drilling Equipment.....	3,604.26	
	<hr/>	
Total Intangible Well Costs .....	74,167.31	
Less:		
Depletion provided on Well No. 16		
Depletion Reserve Dec. 31, 1935.....	28,472.01	
Depletion on		
Olson & Smith Distributions in 1936.....	9,407.29	
Olson & Smith Distributions in 1937.....	8,050.80	
	<hr/>	
Total Depletion Reserve 12-20-37 .....	45,930.10	
	<hr/>	
Net Intangible Drilling Costs.....		28,237.21
		<hr/>
Net loss sustained by Company on abandoning and quit claiming its 50% of 80% Interest in Well No. 16 to J. A. Smith on Dec. 20, 1937 .....		\$ 43,151.96

(Testimony of George F. Meitner.)

## Petitioner's Exhibit No. 57—(Continued)

## DAVIES LEASE

Cost of Lease acquired 2-10-37 .....	\$ 2,000.00	
Escrow Fees, Title and Recording Costs.....	116.75	
		\$ 2,116.75
Total Lease Cost .....		
Cost of uncompleted well acquired by purchase from L. G. King.....	11,000.00	
Water and Gas Lines .....	1,035.68	
Redrilling Costs		
Labor .....	3,387.91	
Hauling .....	1,099.46	
Fuel, Power & Water .....	1,364.35	
Repairs .....	473.03	
Supplies .....	2,310.16	
Tool & Equipment Rental .....	1,220.06	
Insurance .....	262.96	
Miscellaneous .....	588.79	
Depreciation on Drilling Equipment .....	476.27	
Field Overhead Allocated .....	1,456.63	
Total Well Costs .....		24,675.30
Total Lease and Well Costs .....		26,792.05



(Testimony of George F. Meitner.)

## Petitioner's Exhibit No. 57—(Continued)

Less: Cost of Lease acquired.....	2,116.75	
Estimated Salvage Value of Equipment.....	857.17	
Total .....		2,973.92
<hr/>		
Loss sustained on Davies-King Well No. 1 abandoned as a dry hole on April 27, 1937 .....		\$ 23,818.13
		<hr/>

Geo. F. Meitner &amp; Co., Auditors and Accountants

[Endorsed]: U.S.B.T.A. Filed Oct. 4, 1941.

(Testimony of George F. Meitner.)

Q. (By Mr. Burkhead) Mr. Meitner, will you state how the mechanics from a bookkeeping standpoint of this \$43,151.96 was reflected by you on the books of the corporation?

A. Well, an entry was made charging off the equity remaining balanced, the difference between the cost value of the tangible equipment and the intangible drilling cost of the well less the reserve for depreciation on the tangible equipment, and the depletion reserve on the intangible equipment to arrive at, charged off as a loss to profit and loss on the company's records.

Q. In the year 1937? A. In the year 1937.

Q. For your information, Mr. Meitner, the stipulation of facts filed herein, together with the exhibits, contains an Exhibit No. 51 designated Balance Sheet of Barnhart-Morrow Consolidated for the years 1930 to 1935. From your knowledge of the affairs of Barnhart-Morrow Consolidated, the books of the corporation, was there any change in condition of Barnhart-Morrow Consolidated during the year 1936 up to the time that they received the funds from the co-trustees on or about November 14, 1936?

The Member: You said "condition." You mean financial [144] condition?

Mr. Burkhead: I refer to the financial condition of the company.

Q. In other words, did they receive funds from some source or did they pay out funds or did their

(Testimony of George F. Meitner.)

balance sheets and affairs remain about the same during that part of the year?

A. They remained about the same.

Q. I hand you another statement which has been heretofore presented to me and ask you if you can identify it.

A. (Examining document): This is a statement I prepared from the audit report that I submitted in the Olson and Smith trusteeship in the matter of Julian v. Schwartz.

Q. You refer to the audit reports that are in evidence as Exhibits 48 and 49(a)

A. I do. And it shows, as taken from those exhibits throughout that report and the schedules therein, what the total credits were to Barnhart-Morrow Consolidated from the proceeds from oils sold, together with a small item of cash discount on purchases which was credited to Barnhart-Morrow and a small amount of revenue which they received from the sale of junk which was credited to Barnhart-Morrow Consolidated, and two items which are not reflected on those two particular reports, but constitute income constructively received by the company in connection with the litigation of Julian v. Schwartz. [145]

Q. Wait a minute, Mr. Meitner. Can you tell the Court this: State the total amount of proceeds received from the sale of oil and gas by the co-trustees which was allocated to Barnhart-Morrow Consolidated?

(Testimony of George F. Meitner.)

A. Yes. In the audit report of 2-9-37, schedule 1, page 17 of that report, there is a total amount of gross proceeds from oil sales credited to Barnhart-Morrow Consolidated of \$400,690.99, and showing the distribution of that amount to Well No. 1 of \$126,624.21; Well No. 2, \$139,973.37; Well No. 3, \$115,783.37; Well No. 11, \$18,310.04.

With respect to Julian Well No. 16, the gross proceeds are \$63,338.64, and with respect to Well No. 17 the gross proceeds credited to the account of Barnhart-Morrow Consolidated is in two parts, the first part being in the sum of \$14,839.94, and the second amount being \$49,866.31.

Mr. Tonjes: Mr. Meitner, is this schedule a part of any of the exhibits which are in evidence?

The Witness: Yes. These references which I have on this exhibit refer back to my audit report, which are Exhibits—I forget the numbers.

Mr. Tonjes: 48 and 49(a).

The Witness: Yes.

Mr. Tonjes: Is this particular document from which you are testifying now in evidence? Do you know?

The Witness: This is not in evidence that I know of. [146]

Q. (By Mr. Burkhead): But it is the breakdown showing the gross proceeds received by the co-trustees as to each well that was allocated to Barnhart-Morrow Consolidated as reflected by your audit report that is already in evidence, is that a correct statement?

(Testimony of George F. Meitner.)

A. Yes. It summarizes those total credits.

Mr. Tonjes: The figures on this document from which you are testifying are all obtained from the schedules now in evidence?

The Witness: All except the two pages shown on there.

Mr. Tonjes: What two?

The Witness: The gas revenues constructively received by the receiver in Julian v. Schwartz in 1931 and February and March of 1932 which was retained by the Texas Company and applied on the gas drilling contract liability of Barnhart-Morrow Consolidated to that company.

Mr. Tonjes: If your Honor, please, I move that the answer of the witness be stricken from the record on the ground that it merely states his conclusion; that it states his conclusion that all of the evidence, that is the basic facts, are taken from exhibits which are in evidence and this particular document from which the witness is now testifying also shows items constructively received. Well, that necessarily involves a legal conclusion as to when or whether money is or is not constructively received. I think that is argumentative. [147]

The Member: It seems to me that this witness can hardly decide a question of constructive receipt. The objection is sustained to that extent.

Mr. Burkhead: Well——

The Member (Interrupting): You are objecting and moving to strike that part of his answer that



(Testimony of George F. Meitner.)

refers to certain statements about constructive receipt of income, is that correct?

Mr. Tonjes: To the constructive receipt of the income on the ground that that is merely a conclusion of the witness, and the remaining part of the witness' answer on the ground that it is merely an expression of opinion, because he states that all of these figures are shown in the documents already identified and offered and received in evidence.

I don't know the purpose of his question if the facts upon which he bases his statements are in evidence.

Mr. Burkhead: Counsel, the purpose of this document is that it was thought that it might be of some help to the Board in that it is a breakdown of what is actually contained in the audit report, and I was trying to identify it and introduce it in evidence to show the breakdown so it might be helpful to the Court. The actual receipts of the co-trustees that were allocated to the Barnhart-Morrow Consolidated is in evidence. If you desire to let the record stand [148] the way it is, it is perfectly all right with me. It will be a little harder to point to it at a later time.

Mr. Tonjes: My objection was this, further, your Honor: The question involved here is the method for determining the depletion of Barnhart-Morrow Incorporated. The witness' answers lead to the conclusion that a certain amount of this oil was actually allocated to Barnhart-Morrow Company. I think the entire record and the documentary evi-

(Testimony of George F. Meitner.)

dence will show clearly that Barnhart-Morrow never was allocated any particular oil to any years. They were finally given a certain amount of dollars in the year 1936. They never had possession of any of this oil at all and it conflicts with the record as already established. If it doesn't, I hardly think that this witness is the proper way to show any facts which are inconsistent with the record.

The Member: Do you want to say something more, counsel for the petitioner?

Mr. Burkhead: I thought, if your Honor please, that I was by this document putting before the Board and in the record the gross proceeds received by those co-trustees from the sale of oil and gas that might be allocated or that would equal the percentage of interest that Barnhart-Morrow Consolidated had in those wells as established by those judgments. Now, we get that figure and that would be the figure that the petitioner contends it is entitled to use on which to base his [149] depletion. I was next going to ask this witness what the actual amount of cash that was paid over to Barnhart-Morrow by the co-trustees was. Then we have the figure that the defense says should be taken for the purpose of figuring depletion. From there on it seems to me it is a question of law as to which one should be taken. That is all the purpose that I have here and that is the two figures that I am trying to get into the record.

The Member: Is it true that document from which this witness is testifying and to which the

(Testimony of George F. Meitner.)

question as to which objection has been made is directed is a mere breakdown of the books and of what is already in evidence?

Mr. Burkhead: I understand it is a breakdown of the audit reports as to which we referred to as being Exhibits 48 and 49(a).

The Member: If it is a mere breakdown of that for the purpose of more clearly analyzing the situation or at least verifying it for the purpose of examination later, it seems to me that there is no prejudice in admitting it. I am not, of course, going to let the witness decide questions of constructive receipt, but the mere fact that this breakdown is placed before me doesn't indicate and, as admitted in evidence, does not indicate that I am going to allow that question to be decided by the witness or that his evidence is material in that regard. [150]

Mr. Tonjes: With that limitation, your Honor, I have no objection to the questions and I will go so far as to say that if this witness will testify that this is a statement prepared by him for the purpose of determining how much cash Barnhart-Morrow was entitled to, I will admit the document in evidence.

Mr. Burkhead: No, this is not the statement to show how much cash Barnhart-Morrow is entitled to. That is covered in another document, isn't it?

The Witness: No.

May I state that these amounts were all taken into consideration which resulted into the net cash which finally was paid to Barnhart-Morrow Consolidated.

(Testimony of George F. Meitner.)

Mr. Tonjes: Was the purpose of the preparation of this document to determine how much cash Barnhart-Morrow would get?

The Witness: That is right.

Mr. Tonjes: That was the only reason for its preparation?

The Witness: That is right.

Mr. Tonjes: I don't have any objection, that being the purpose of the document, your Honor, but I can't admit that these items which are classified constructive receipts and proceeds of oil allocated to Barnhart-Morrow as being proper.

The Member: Well, I don't understand that the instrument [151] or the testimony is offered as decisive upon that question. It is merely clarifying.

Your objection is overruled and exception allowed and the partial ruling in that regard is withdrawn. Exception allowed to the petitioner. I am receiving this instrument and this testimony as clarification of the books and the records already in evidence and as not decisive of any questions.

The Clerk: 58, if your Honor please.

The Member: Admitted in evidence as Petitioner's Exhibit No. 58.

(The said document, so offered and received in evidence, was marked Petitioner's Exhibit No. 58, and made a part of this record.)

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# PETITIONER'S EXHIBIT No. 58

## BARNHART-MORROW CONSOLIDATED

Gross Proceeds of Production from Julian Wells Nos. 1, 2, 3, 11, 16 and 17 for the Period December 1, 1930 to November 14, 1936 Being Gross Proceeds Received from Production by Chas. Allison and/or C. L. Olson and J. A. Smith, Receivers and/or Co-Trustees in the Matter of C. C. Julian v. Schwartz et al., Superior Court Case No. 315345, Credited to Barnhart-Morrow Consolidated; as Determined Pursuant to Judgment Rendered by the Court in Said Matter and Income Constructively Received by Barnhart-Morrow Consolidated in Said Matter.

Geo. F. Meitner & Co. Audit  
Reports re C. L. Olson & J. A. Smith  
Co-Trustees - Julian v. Schwartz

Details	Dated	Exhibit or Schedule	Page	Total	Well No. 1	Well No. 2	Well No. 3	Well No. 11	Well No. 16
Gross proceeds from Oil Sales impounded by Co-trustees to Barnhart-Morrow Consolidated									
Julian Wells Nos. 1, 2, 3 and 11.....	2-9-37	Exhibit B	11}	\$400,690.99	\$126,624.21	\$139,973.37	\$115,783.37	\$ 18,310.04	
Julian Well No. 16.....	2-9-37	Schedule 1	17{						
50% of \$126,677.27.....	2-9-37	Exhibit B	11}	63,338.64					\$ 63,338.64
Julian Well No. 17.....	2-9-37	Schedule 4	22{						
50% of 83-1/3% until \$29,679.88 produced.....	2-9-37	Exhibit B	11}	14,839.94					
Then 38% of 100% or 45.6% of 83-1/3% of \$109,355.94 production.....	2-9-37	Schedule 5	23}	49,866.31					
Balance of Gas Revenues Impounded released to J. A. Smith in November 1936, constructively received by Barnhart-Morrow Consolidated in the year 1936									
50% of total balance of \$929.84.....	2-9-37	Exhibit B	14	464.92	20.67	29.90	54.33	111.55	123.59
Gas Revenues constructively received by Receiver in Julian v. Schwartz in 1931 and February and March 1932, retained by the Texas Co. and applied on Gas Drilling Contract liabilities of Barnhart-Morrow Consolidated to that company.....				1,163.30					67.05
Oil Royalty liability of Barnhart-Morrow Consolidated to A. L. Jameson on Julian Well No. 17 liquidated through distribution of 50% of 83-1/3% until \$29,679.88 produced.....				2,699.63					
Total.....				533,063.73	126,644.88	140,003.27	115,837.70	18,421.59	63,529.28
Less—Amount held under attachment in the matter of O. A. Cargill v. Barnhart-Morrow Consolidated being 7½% of 70% of the proceeds realized from oil produced from Julian Wells Nos. 1, 2, 3 and 11 (or 7½% of \$616,447.71 being 7½% of \$194,806.49 for Julian Well No. 1, 7½% of \$215,343.66 for Julian Well No. 2; 7½% of \$178,128.27 for Julian Well No. 3 and 7½% of \$28,169.29 for Julian Well No. 11 as shown on Schedule 1, page 17 of audit report dated 2-9-37.....	9-22-37	Exhibit A1	6	46,233.58	14,610.49	16,150.77	13,359.62	2,112.70	
Total gross proceeds from oil and gas produced impounded and credited to Barnhart-Morrow Consolidated and oil and gas income constructively received by Barnhart-Morrow Consolidated.....				486,830.15	112,034.39	123,852.50	102,478.08	16,308.89	63,529.28
Other Income Credits									
Discounts Received.....	9-22-37	Exhibit B	11	2,028.50	338.09	338.07	338.09	338.06	338.06
Sale of Junk.....	9-22-37	Exhibit B	11	45.00	5.00	5.01	5.00	20.00	5.00
Total credits to Barnhart-Morrow Consolidated from Gross proceeds from oil Sales impounded, Gas Revenues constructively received, liabilities liquidated and other income credits.....				\$488,903.65	\$112,377.48	\$124,195.58	\$102,821.17	\$ 16,666.95	\$ 63,872.36

(Geo. F. Meitner & Co., Auditors and Accountants)

[Endorsed]: U.S.B.T.A. Filed Oct. 4, 1941.



(Testimony of George F. Meitner.)

The Member: I don't know that you have offered it yet. You were offering the questions with reference to it. Had you offered the instrument?

Mr. Burkhead: I will offer it at this time.

The Member: Very well. It is admitted in evidence as Petitioner's Exhibit 58.

Mr. Tonjes: The respondent perhaps had better remove his objections for the reason stated.

The Member: The objection is overruled and exception allowed the respondent.

Q. (By Mr. Burkhead): Mr. Witness, I show you a statement that is prepared in two parts, which purports to be distribu- [152] tions made by C. L. Olson and J. A. Smith, co-trustees of Julian Wells No. 1, 2, 3, 11, 16, and 17 in case No. 315345, to Barnhart-Morrow Consolidated pursuant to the judgment rendered and the orders of the court in that case referred to, and it also purports to contain income constructively received by Barnhart-Morrow Consolidated.

Now, with reference to those incomes constructively received, what do you understand to mean by constructive receipt. How were those incomes actually received? Will you explain what those incomes are and where they came from so that perhaps we can strike that word, that legal conclusion, constructively received?

A. Well, of the \$464.92 shown as 50 per cent of the sum of \$929.84, gas revenues as shown in my audit report of 2-9-37, all of the revenues by stipulation in the Julian v. Schwartz matter were released

(Testimony of George F. Meitner.)

to J. A. Smith, although Barnhart-Morrow Consolidated had an interest therein.

Q. In other words, on this document you have to J. A. Smith balance of cash revenues paid to Mr. Smith constructively received by Barnhart-Morrow Consolidated 50 per cent of \$929.84, the amount being that he received \$464.92. Now, you say that Barnhart-Morrow really was entitled to that gas revenue that was released to Mr. Smith, but you mean by constructively received that it should have gone through Barnhart-Morrow and then to Mr. Smith? [153]

A. That is right.

Q. The only difference is the fact that it skipped Barnhart-Morrow and went to Mr. Smith?

A. No. It went to Mr. Smith and then in the settlement, which is a part of the exhibits here, these items are all taken into consideration in that demand of Mr. Smith on Barnhart-Morrow.

Q. Now, this document has an item "Total Distributions to and Amounts Constructively Received by Barnhart-Morrow Consolidated in November 1936, \$142,989.99."

You arrived at that figure by considering a cash item paid to Ralph S. Armour, the receiver of Barnhart-Morrow, in the amount of \$17,852.13, and the actual cash paid to Barnhart-Morrow Consolidated by the co-trustees in 1936 was \$112,000, is that correct?

A. That is correct.

Q. And at the time the receivers turned the wells over to Barnhart-Morrow—I mean the co-trustees in November of 1936 pursuant to the judgment, they

(Testimony of George F. Meitner.)

also turned some equipment over to the Barnhart-Morrow, didn't they?

A. Yes, there was valuable equipment.

Q. Now, you set that equipment up on the books of Barnhart-Morrow and you have it on this statement at the depreciated cost value as of that time?

A. That is right. [154]

Q. In the amount of \$7,992.90?

A. That is correct.

Q. The co-trustees had on deposit some compensation insurance funds in the amount of \$300 and you charged that to Barnhart-Morrow?

A. That is correct.

Q. The gas item of \$464.92 we have covered.

To the Texas Company, gas revenues applied on drilling gas contract, you also set that up as having been constructively received by Barnhart-Morrow Consolidated in the amount of \$1,163.30. Did that not arise in this way, that the Texas Company withheld that amount and applied on a contract that they had with Barnhart-Morrow Consolidated?

A. That is correct. It was liquidating a liability of Barnhart-Morrow to them.

Q. And you called that constructive receipt of Barnhart-Morrow Consolidated, is the way you set it up here, is that correct? A. That is correct.

Q. Now, an item of A. L. Jameson, balance of oil royalty liquidated constructively received by Barnhart-Morrow Consolidated, \$2,699.63, will you explain why you call that constructive receipt?



(Testimony of George F. Meitner.)

A. This was a liability that had accrued to the books of Barnhart-Morrow to A. L. Jameson in the sum of \$2,699.63. [155] By a stipulation of the amount as to what sum would have to be recovered from the production of Well No. 17 before a different percentage of distribution was again to be used of distributing the proceeds of the production of that well to the holders of interest therein, the amount that was stipulated included this amount that was owned by Barnhart-Morrow Consolidated in the matter of Julian v. Schwartz, so that when that was liquidated through that trusteeship, it automatically liquidated one liability of Barnhart-Morrow to Jameson; and, therefore, with the elimination of that liability it automatically became income of Barnhart-Morrow, as I have termed here, constructively received by it.

Q. So that adding those amounts of actual cash received from what you call constructive receipts and the equipment, that is, depreciated cost value, the insurance premiums paid and so forth, you arrived at a figure of \$142,989.99 which you admit that the taxpayer received in the year 1936?

A. That is correct.

Q. And you have set this up on a schedule for the purpose of breaking it down and showing those various different items?

A. That is correct.

Q. It is all included in your reports, or is it included in those audit reports?

A. Well, all of this is not included in those audit reports. Only those items that are specifically

(Testimony of George F. Meitner.)

marked here are in- [156] cluded here. In other words, the actual cash that was paid to the receiver, the actual cash paid to Barnhart-Morrow Consolidated, and the amount of the gas revenues that the trustees had, they were paid to J. A. Smith as shown in those audit reports.

Q. In other words, you have referred to those as exhibit B-11, and exhibit B-14. Those items are shown in the audit report?

A. That is correct.

Q. Where did you obtain the other figures?

A. The item of depreciated cost value of tangible equipment represents such assets that were acquired for the operation of the different wells that had a life longer than one year, and while the trustees kept their record clearly on a cash receipts and disbursements basis, these capital assets that were purchased were treated as material in repairs.

Q. Now, on this same instrument you have covered the year 1937, but I don't note that there were any constructive receipts during that year. You show various items totalling \$122,371.37 which represent the income of the taxpayer for the year 1937 as reflected by the cash paid, mining rights and taxes paid for its benefit, the cash having been paid from the co-trustees; is that correct?

A. That is correct.

Q. And also you have several columns here representing each [157] well by number with a figure beneath or in each column underneath each well number. What are those figures?

(Testimony of George F. Meitner.)

A. (Pause.)

Q. For instance, Well No. 1, \$38,039.82 for the year 1936.

A. Those are an allocation of the cash and other items there that were making up the \$142,989.99 which are based upon the total gross credits that were given to Barnhart-Morrow as shown on this exhibit previously presented, the aggregate total of all such wells being \$488,903.65.

Mr. Burkhead: I will offer this document as Petitioner's Exhibit next in order.

Mr. Tonjes: No objection.

The Member: Admitted in evidence as Petitioner's Exhibit No. 59.

The Clerk: That is correct, your Honor.

(The document, so offered and received in evidence, was marked Petitioner's Exhibit No. 59, and made a part of this record.)



## PETITIONER'S EXHIBIT No. 59

## BARNHART-MORROW CONSOLIDATED

Distributions Made by C. L. Olson and J. A. Smith, Co-Trustees of Julian Wells Nos. 1, 2, 3, 11, 16 and 17, in the Matter of C. C. Julian v. W. A. Schwartz, et al., Superior Court Case No. 315945, to Barnhart-Morrow Consolidated, Pursuant to Judgment Rendered and Orders of the Court in Said Matter, and Income Constructively Received by Barnhart-Morrow Consolidated, in and for the Years as Shown Reconciled with the Gross Credits to Barnhart-Morrow Consolidated and Charges Made Against Barnhart-Morrow Consolidated by the Co-Trustees in Said Matter of C. C. Julian v. W. A. Schwartz, et al.

Gso, F. Meitner & Co. Audit  
Report re: C. L. Olson & J. A. Smith  
Co-Trustees - Julian v. Schwartz

Details	Date	Exhibit or Schedule	Page	Detail	Total	Well No. 1	Well No. 2	Well No. 3	Well No. 11	Well No. 16	Well No. 17
Received in year 1936					\$26,550.82	\$ 70,644.84	\$ 74,886.24	\$ 54,994.29	\$ 25,218.17	\$ 42,265.65	\$ 47,977.97
Cash paid to Ralph S. Armour, Receiver for Barnhart-Morrow Consolidated	2-9-37	Exhibit B	11	\$ 17,852.13							
Cash paid to Barnhart-Morrow Consolidated Depreciated cost value of tangible equipment acquired by Trustees of wells, possession of which was delivered on November 14, 1936	2-9-37	Exhibit B	11	112,000.00							
Compensation Insurance—deposit assigned				7,992.90							
Liabilities of Barnhart -Morrow Consolidated through C. L. Olson & J. A. Smith, Co-Trustees:				300.00							
To J. A. Smith—Balance of gas revenues paid to Mr. Smith constructively received by Barnhart-Morrow Consolidated—50% of \$929.84	2-9-37	Exhibit D	14	464.92✓							
To Texas Co.—Gas Revenues applied on Drilling Gas Contract—constructively received by Barnhart -Morrow Consolidated				1,163.30							
To A. L. Jameson—Balance of oil royalty liquidated constructively received by Barnhart-Morrow Consolidated				2,699.63							
To C. L. Olson and J. A. Smith, Co-trustees—Liability of Ralph S. Armour, Receiver for Barnhart-Morrow Consolidated, cancelled by offset				517.11							
Total distributions to and amounts constructively received by Barnhart-Morrow Consolidated in November, 1936.....					\$142,989.99	\$ 38,039.82	\$ 40,323.67	\$ 29,612.53	\$ 13,579.12	\$ 22,758.60	\$ 25,834.49
Received in year 1937											
Cash paid to Barnhart-Morrow Consolidated on February 28, 1937.....	9-22-37	Exhibit B	8	63,000.00							
Mining rights taxes, State oil and gas fund taxes, Personal Property and other taxes paid for account of Barnhart-Morrow Consolidated in 1937	9-22-37	Exhibit B	8	1,333.43							
Cash paid to Barnhart -Morrow Consolidated on October 21, 1937											
Cash credit as of 9-15-37.....	9-22-37	Exhibit A-1	6								
Add—cash collected subsequent to 9-15-37 .....				.62							
Total .....				58,037.94							
Less—Trustees Expenses											
9-15-37 to 10-21-37 .....				7.98							
Actual cash paid .....											
Total distributions to and amount constructively received by Barnhart-Morrow Consolidated during year 1937 .....					122,371.37	32,554.62	34,509.14	25,342.52	11,621.06	19,476.90	22,109.25
Distributions made subsequent to the years 1936 and 1937											
Accounts Receivable .....	9-22-37	Exhibit A-1	6	190.08							
Less - Collection made subsequent to 9-15-37 .....				.62	189.46	50.40	53.43	39.24	17.99	30.15	34.23
Total distributions received by Barnhart-Morrow Consolidated .....					\$265,550.82	\$ 70,644.84	\$ 74,886.24	\$ 54,994.29	\$ 25,218.17	\$ 42,265.65	\$ 47,977.97



## PART 2—EXHIBIT No. 59

## BARNHART-MORROW CONSOLIDATED—(Continued)

Distributions Made by C. L. Olson and J. A. Smith, Co-Trustees of Julian Wells Nos. 1, 2, 3, 11, 16 and 17, in the Matter of C. C. Julian v. W. A. Schwartz, et al., Superior Court Case No. 315345, to Barnhart-Morrow Consolidated, Pursuant to Judgment Rendered and Orders of the Court in Said Matter, and Income Constructively Received by Barnhart-Morrow Consolidated, in and for the Years as Shown Reconciled with the Gross Credits to Barnhart-Morrow Consolidated and Charges Made Against Barnhart-Morrow Consolidated by the Co-Trustees in Said Matter of C. C. Julian v. W. A. Schwartz, et al.

Geo. F. Meitner & Co. Audit  
Report re: C. L. Olson & J. A. Smith  
Co-Trustees - Julian v. Schwartz

Details	Date	Exhibit or Schedule	Page	Detail	Total	Well No. 1	Well No. 2	Well No. 3	Well No. 11	Well No. 16	Well No. 17
RECONCILEMENT											
Total credits to Barnhart-Morrow Consolidated from gross proceeds from oil sales impounded, gas revenues constructively received, liabilities liquidated and other income credits by Co-Trustees of Julian Wells Nos. 1, 2, 3, 11, 16 and 17....					\$488,903.65	\$112,377.48	\$124,195.58	\$102,821.17	\$ 16,666.95	\$ 63,872.36	\$ 68,970.11
Total charges against Barnhart - Morrow Consolidated by Co-trustees of Julian Wells Nos. 1, 2, 3, 11, 16 and 17:											
Net charges applicable to expense of Well Operations .....					192,709.98	35,804.57	43,580.02	42,412.65	37,050.60	17,260.75	16,601.39
Taxes Paid .....					13,004.56	2,823.55	2,733.24	2,419.02	1,298.04	1,739.92	1,990.79
Receivers and/or Co-Trustees net expense					17,638.29	3,104.52	2,996.08	2,995.21	3,536.48	2,606.04	2,399.96
Total.....					223,352.83	41,732.64	49,309.34	47,826.88	41,885.12	21,606.71	20,992.14
Net credits to Barnhart-Morrow Consolidated received as set forth above.....					\$265,550.82	\$ 70,644.84	\$ 74,886.24	\$ 54,994.29	\$ 25,218.17	\$ 42,265.65	\$ 47,977.97

[Endorsed]: U.S.B.T.A. Filed Oct. 4, 1941.



(Testimony of George F. Meitner.)

The Clerk: Consisting of two pages.

The Member: It is now 12:00 o'clock, gentlemen. I have told the next case to be here at this time, with an idea of getting an idea about placing them on this docket when their case will come up. I would like to have your advice now as to how much longer this case will take, if you can give me any idea.

Mr. Burkhead: It isn't going to take me but I'd say 30 [158] minutes more and I will quit, if I use that much time.

Mr. Tonjes: I don't expect to have any lengthy cross examination, your Honor.

Mr. Burkhead: I am about to offer in evidence statements for the years 1936 and 1937 which are entitled "Gross Income, Expense, Depletion and Net Income for the Year Ended December 31, 1936," and the same thing for December 31, 1937. Now, in these two documents the author has set up an item depletion 27½ per cent of net amount of oil and gas revenues limited to 50 per cent of net operating profit.

It may be stipulated that that item in each of these documents and the figures set opposite that item may be disregarded entirely by the Board as though it did not appear upon the face of this instrument, and the same is true with reference to the words "Net Amount Subject to Income Tax of" which appears in the statement on the left margin of each of these documents opposite the figure \$73,-776.96.

The Member: Now, counsel, let me suggest that

(Testimony of George F. Meitner.)

you run a line through that which you are striking, because otherwise I have to go to the record to see that it is stricken and might use it, or at least be confused in the using of it by having to go to the record to strike it. Just place a little notation that the part marked out is not offered, or something to that effect, and then I won't have any difficulty with it when I come to see this exhibit. [159]

Mr. Burkhead: With that limitation, I offer the document with reference to the year 1936 as the Petitioner's Exhibit No. 60, and the document with reference to the year 1937 as Petitioner's Exhibit No. 61.

Mr. Tonjes: No objection.

The Member: Petitioner's Exhibit Nos. 60 and 61 are admitted in evidence.

(The statements, so offered and received in evidence, were marked Petitioner's Exhibit 60 and 61, and made a part of this record.)

	Well No. 3	Well No. 11	Well No. 16	Well No. 17
INC				
Oil	2,521.51	\$ 316.59	\$ 4,561.79	\$ 2,496.51
W	555.00			



## PETITIONER'S EXHIBIT No. 60

## BARNHART-MORROW CONSOLIDATED

## GROSS INCOME, EXPENSE, DEPLETION AND NET INCOME

FOR THE YEAR ENDED DECEMBER 31, 1936

Details	Total	Well No. 1	Well No. 2	Well No. 3	Well No. 11	Well No. 16	Well No. 17
<b>INCOME</b> (From Nov. 1, 1936 to Dec. 31, 1936)							
Oil Sales .....	\$ 18,016.23	\$ 4,264.18	\$ 3,855.66	\$ 2,521.50	\$ 316.59	\$ 4,561.79	\$ 2,496.51
Wet Gas Sales .....	2,675.87	547.41	268.13	557.89	589.59	257.27	455.58
Dry Gas Sales .....	89.44	8.23	5.70	9.82	10.73	32.28	22.68
Total.....	20,781.54	4,819.82	4,129.49	3,089.21	916.91	4,851.34	2,974.77
Less—Amounts due Participating Interests in Julian Wells, No. 16 and 17 .....	3,260.94					2,050.67	1,210.27
Net Amount Oil and Gas Revenues.....	17,520.60	4,819.82	4,129.49	3,089.21	916.91	2,800.67	1,764.50
<b>EXPENSES</b>							
Well Operating Costs and Maintenance—Schedule D1.....	6,991.06	731.38	656.37	643.70	719.05	3,466.85	773.71
Field Overhead—Schedule D1 .....	1,908.00	318.00	318.00	318.00	318.00	318.00	318.00
General and Administrative Expense—Schedule D1.....	4,279.78	713.30	713.30	713.30	713.30	713.29	713.29
Taxes .....	1,123.61	187.88	187.70	187.19	186.39	187.52	186.93
Total Expenses .....	14,302.45	1,950.56	1,875.37	1,862.19	1,936.74	4,685.66	1,991.93
<b>NET OPERATING PROFIT OR LOSS</b> before deduction for depletion allowance .....	3,218.15	2,869.26	2,254.12	1,227.02	1,019.83	1,884.99	227.43
Depletion — 27 1/5% of Net Amount of Oil and Gas Revenues *limited to 50% of net operating profit.....	3,074.57	1,325.45	1,135.61	613.51*			
<b>OPERATING PROFIT</b> (or Loss).....	\$ 143.58	\$ 1,543.81	\$ 1,118.51	\$ 613.51	\$ 1,019.83	\$ 1,884.99	\$ 227.43
<b>OTHER INCOME AND CREDITS TO PROFIT AND LOSS</b>							
Rental on Drilling Equipment .....	\$ 5,000.00						
Distributions received in 1936 from C. L. Olson and J. A. Smith, Co-Trustees of Julian Wells Nos. 1, 2, 3, 11, 16 and 17 from impounded funds, pursuant to Court Order dated July 23, 1934 which order became effective on Oct. 28, 1936, issued in the matter of Julian vs. Schwartz, et al; Superior Court Case No. 315-345. Total amount received in 1936 as shown on Exhibit B, \$142,989.99, less depletion allowable and applicable thereto of \$69,213.03, or a net amount subject to income tax of .....	73,776.96						
Claim for interest accrued on note indebtedness relinquished in 1936.....	391.67✓						
Total.....	79,168.63						
<b>OTHER EXPENSE AND DEBITS TO PROFIT AND LOSS</b>							
Interest Paid .....	1,409.36✓						
Loss, account Royalties paid in 1930 to H. B. Fleisher Well No. 16, repaid to J. A. Smith in 1936, pursuant to settlement made in accordance with judgment rendered in the matter of Julian vs. Schwartz.....	16,500.10✓						
Receivership Expenses—Schedule D 2.....	17,574.68✓						
Total .....	35,484.14						
Net Other Income to Profit and Loss.....	43,684.49						
<b>NET TAXABLE INCOME FOR THE YEAR 1936</b> .....	\$ 43,828.07						

Geo. F. Meitner &amp; Co., Auditors and Accountants

[Endorsed]: U.S.B.T.A. Filed Oct. 4, 1941.

[In longhand]: Part marked out omitted by stip.

## PETITIONER'S EXHIBIT No. 61

## BARNHART-MORROW CONSOLIDATED

## GROSS INCOME, EXPENSE, DEPLETION AND NET INCOME

YEAR ENDED DECEMBER 31, 1937

Details	Santa Fe Springs Lease							Kern County Land Company Lease
	Total	Well No. 1	Well No. 2	Well No. 3	Well No. 11	Well No. 16	Well No. 17	Wells Nos. 1, 2, 3 & 4
<b>INCOME</b>								
Oil Sales .....	\$ 82,646.28	\$ 27,379.19	\$ 16,017.49	\$ 12,381.36		\$ 10,077.18	\$ 9,117.36	\$ 7,673.70
Wet Gas Sales .....	2,146.06	398.13	252.33	405.93	\$ 396.25	212.03	481.39	
Dry Gas Sales .....	363.28	49.08	27.75	49.93	65.94	60.66	109.92	
Total Gross Income .....	\$5,155.62	27,826.40	16,297.57	12,837.22	462.19	10,349.87	9,708.67	7,673.70
Less—Amounts due Participating Interests in Julian Wells Nos. 16 and 17 .....	4,930.24					2,885.14	2,045.10	
Net Amount Oil and Gas Revenue.....	80,225.38	27,826.40	16,297.57	12,837.22	462.19	7,464.73	7,663.57	7,673.70
<b>EXPENSES</b>								
Well Operating Costs and Maintenance.....	38,180.97	3,554.36	4,285.45	4,488.11	1,092.06	6,134.73	4,846.95	13,779.31
Field Overhead Expense .....	15,977.03	1,536.01	1,536.00	1,536.00	1,536.00	1,536.00	1,536.00	6,761.02
General and Administrative Expense .....	15,031.38	1,503.14	1,503.14	1,503.14	1,503.14	1,503.14	1,503.14	6,012.54
Taxes .....	4,603.41	800.15	679.86	559.79	346.19	468.10	382.16	1,367.16
Loss sustained on Tubing Collapse.....	1,081.54					1,081.54		
Total Expense .....	74,874.33	7,393.66	8,004.45	8,087.04	4,477.39	10,723.51	8,268.25	27,920.03
<b>NET OPERATING LOSS OR PROFIT before Deduction for De- pletion Allowance .....</b>								
	5,351.05	20,432.74	8,293.12	4,750.18	4,015.20	3,258.78	604.68	20,246.33
Depletion — 27 1/2 % of Net Amount of Oil and Gas Revenues — *limited to 50% of net operating profit.....	14,173.91	7,652.26	4,146.56*	2,975.99*				
NET LOSS after allowance for Depletion.....	<del>\$ 699.86</del>	<del>\$ 12,780.48</del>	<del>\$ 4,146.56</del>	<del>\$ 2,975.99</del>	<del>\$ 4,015.20</del>	<del>\$ 3,258.78</del>	<del>\$ 604.68</del>	<del>\$ 20,246.33</del>
<b>OTHER INCOME AND CREDITS TO PROFIT AND LOSS</b>								
Distributions received in 1937 from C. L. Olson and J. A. Smith, Co-trustees of Julian Wells Nos. 1, 2, 3, 11, 16 and 17 from im- pounded funds pursuant to Court Orders issued in 1937, in the matter of Julian v. Schwartz, et al., Superior Court Case No. 315345. Total amount received in 1937 \$122,371.37 less depletion allowable and applicable thereto of \$59,232.76 leav- ing a net amount subject to income tax of.....	63,138.61							
Distributions received on Oil Participating Agreements in Julian Wells Nos. 1, 2, and 3 being dividends received for the year 1937 .....	14,026.50							
Cash Discounts Received .....	505.69							
Income from sale of Miscellaneous Casing.....	121.42							
Income for drilling oil well for others.....	3,000.00							
Total Other Income .....	80,792.22							
Total .....	71,969.36							
<b>OTHER INCOME DEDUCTIONS</b>								
Loss sustained on Davies Well No. 1 abandoned on April 27, 1937	23,818.13							
Loss sustained on Julian Well No. 16 abandoned and quit claimed to J. A. Smith December 20, 1937.....	<del>43,151.96</del>							
Interest Paid .....	3,089.51							
Total Income Deductions .....	70,059.60							
<b>NET INCOME FOR THE YEAR 1937.....</b>	<b>\$ 1,909.76</b>							

[In longhand]: Part marked out by stipulation



(Testimony of George F. Meitner.)

Mr. Burkhead: The petitioner rests.

The Member: The petitioner rests. What says the respondent?

Mr. Tonjes: The respondent rests.

In the matter of preparing briefs, might I state that the record in this case contains a very long stipulation and a very voluminous amount of documents, and I think perhaps that will be more helpful to the Board if I be permitted to file a reply brief to the Petitioner's opening brief. I am not at all sure as to how the Petitioner expects to correlate all of this mass of evidence with respect to the different issues.

Mr. Burkhead: I think in fairness that would be probably the correct way to handle it.

The Member: It seems to me that this is a case that lends itself to that. [160]

Very well. The petitioner will have until—is there any reason why you need more than 45 days?

Mr. Burkhead: That is after the receipt of the transcript?

The Member: No. From this date. We never can tell about the receipt of the transcript, and this reporter has a considerable load.

I will allow you until November 25th for the petitioner to brief. That will give you more than the 45 days, somewhat; and until December 25th for the respondent to answer, the petitioner to have until January 10, 1942, to reply.

The Clerk: December 25th is a legal holiday, being Christmas day.

(Testimony of George F. Meitner.)

The Member: Yes. I realize that. Make it then December 24th.

The Clerk: And January what?

The Member: January 10th. That will give them 16 days.

(Witness excused.)

Hearing Concluded.

[Endorsed]: U.S.B.T.A. Filed Oct. 21, 1941.

[161]

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[Title of Board and Cause.]

#### FINDINGS OF FACT AND OPINION

Docket No. 105859. Promulgated August 20, 1942.

1. In 1930 petitioner was indemnified against any loss resulting from payment to the indemnitor of the proceeds of production of an oil well in accordance with existing agreements. The indemnitor died in 1934, leaving no estate. In 1936 the courts decided that an assignee of the indemnitor was entitled to the amount that had been paid to the indemnitor. Held, that the debt was ascertained to be worthless and charged off in 1936.

2. In 1936 petitioner canceled and credited to surplus the amount of \$7,000 representing salary accrued on its books in 1931 in favor of one of its officers. Petitioner sustained a net loss of about \$90,000 in 1931. Held, that the amount of salary



canceled in 1936 does not constitute taxable income to petitioner in that year.

3. Petitioner was in receivership during a portion of 1936. Held, that petitioner has failed to prove that it was insolvent at any time during that period within the meaning of section 14 (d) (2) of the Revenue Act of 1936.

4. Petitioner's oil and gas wells were in possession of and being operated by receivers and/or trustees from 1931 until November 1936, during which time the proceeds of production, less operating expenses chargeable to petitioner, were impounded pending judicial determination of the parties entitled thereto. Expenses of operation were deducted in determining the net amount payable to petitioner, part of which net amount was paid in 1936. Held, that the amount paid to petitioner in 1936, plus the amount of income which had been expended for operating expenses, constitutes gross income received from the property by petitioner in 1936 for depletion purposes.

5. In 1937 one of petitioner's wells ceased to produce and was transferred by quitclaim deed to one of its stockholders. Held, that petitioner may not deduct any amount as a loss, on account of failure to prove the cost of the property.

B. W. Burkhead, Esq., and Harold C. Morton, Esq., for the petitioner.

E. A. Tonjes, Esq., for the respondent.

This proceeding involves the redetermination of deficiencies in income tax for the years 1936 and 1937 in the respective amounts [180] of \$32,-

767.96 and \$15,816.89. The issues are (1) whether respondent erred in disallowing a bad debt deduction of \$16,500.10; (2) whether salary in the amount of \$7,000 accrued in 1931 and canceled in 1936 constitutes taxable income; (3) whether respondent erred in determining that petitioner was not insolvent during a period of receivership and therefore was subject to surtax on undistributed profits; (4) whether respondent erred in not allowing a greater amount as a deduction for depletion; and (5) whether petitioner sustained a deductible loss upon the abandonment of an oil well known as Well No. 16, and, if so, whether it was a capital loss or an ordinary loss. Other issues raised by the petitioner were abandoned at the hearing. The stipulation of facts filed in the proceeding is incorporated herein by reference as part of our findings of fact. Material portions thereof will be set forth in the findings of fact made from other evidence.

### FINDINGS OF FACT

Petitioner was organized in 1926 under the laws of California. It kept its books and filed its returns on the accrual basis. Petitioner's returns for the taxable years were filed with the collector for the sixth district of California.

In 1922 and 1923 C. C. Julian acquired several oil leases covering property in the Santa Fe Springs, California, field. The leases were assigned to the Citizens Trust & Savings Bank, Los Angeles, California, in trust, with direction to pay expenses of the trust and any balance to the trustor or such per-

son as he designated. The trustor had exclusive control of the leases as agent of any assignee of any interest therein. Pursuant to this plan C. C. Julian sold to the public fractional interests in wells to be drilled under the leases. Five oil and gas wells, known as Julian Wells Nos. 1, 2, 3, 11, and 12, were drilled with the proceeds of such sales.

In 1925 C. C. Julian entered into an agreement with D. R. Morrow and W. J. Barnhart by the terms of which the latter agreed to operate the wells for 50 percent of the production of the wells, exclusive of royalties. In 1927 the operating agreement was assigned to petitioner. In 1929 petitioner's compensation for operating the property was increased to 65 percent of the gross production, exclusive of royalties, out of which it was required to pay all operating expenses.

On March 9, 1928, the United Oil Well Supply Co. and others entered into an agreement, hereinafter referred to as the United lease, leasing certain property to W. J. Barnhart. On September 28, 1928, W. J. Barnhart assigned to C. C. Julian such portion of the lease as related to certain property described in the lease, and another portion to petitioner. On the same day petitioner agreed in writing [181] with W. J. Barnhart to drill at its own expense a well on the property to productive sands below 5,000 feet. After payment of landowners' royalty of  $16\frac{2}{3}$  percent, if a well was drilled less than 5,000 feet, and 20 percent if drilled more than 5,000 feet, petitioner was entitled to receive \$100,000 out of the remaining production.

Thereafter the 83 1/3 per cent interest of the lessee was to be divided equally between petitioner and W. J. Barnhart after paying operating expenses, except that Barnhart's interest was not chargeable with more than \$250 per month while the well was flowing and \$500 per month while the well was being pumped. Petitioner also agreed on September 28, 1928, in another instrument, to pay C. C. Julian the sum of \$2,500 to be relieved of its obligation to drill a well deeper than 5,000 feet and to accept \$80,000, instead of \$100,000, for the drilling of such a well. Thereafter petitioner drilled a productive well on the property, known as Julian Well No. 16, to a depth of less than 5,000 feet.

On September 28, 1928, W. J. Barnhart assigned his interest in the operating agreement to Wm. M. Cady. On July 25, 1929, Wm. M. Cady assigned his interest to James B. Boyle as security. In acquiring the United lease and making the assignment to Wm. M. Cady, W. J. Barnhart was acting for C. C. Julian.

Well No. 16 produced prior to May 1930 sufficient oil and gas to pay petitioner out of 83 1/3 percent of the production the consideration of \$80,000 for drilling the well.

On May 15, 1930, C. C. Julian directed petitioner to pay to H. B. Flesher his one-half share of the proceeds of production of Well No. 16, this being the same interest W. J. Barnhart, acting for C. C. Julian, had assigned in writing to Wm. M. Cady on September 28, 1928.

On July 18, 1930, petitioner advised C. C. Julian by letter that on August 20, 1929, it had received a communication from James B. Boyle in which he claimed ownership of his interest in production of Well No. 16. On July 25, 1930, C. C. Julian advised petitioner that James B. Boyle had no interest in production of the well above 5,000 feet. The letter also contained the following:

The undersigned hereby agrees to fully protect and indemnify your company against any and all action or actions that may be brought against you by reason of you paying to me, or to my properly authorized agent, such sums of money to which I am entitled in accordance with existing agreements.

At various times thereafter in 1930 petitioner paid to H. B. Flesher the sum of \$16,500.10 out of 83 1/3 percent of the proceeds of production of Well No. 16.

On November 30, 1931, Wm. M. Cady assigned his interest in Well No. 16 to J. A. Smith. [182]

On September 28, 1928, W. J. Barnhart assigned to C. C. Julian the remainder of the United lease not involved in Well No. 16. Thereafter Well No. 17 was drilled on the premises. In 1930 petitioner undertook to place the well in condition to produce from the Meyer sand and if successful petitioner was to receive \$78,000, payable out of 41 2/3 percent of the production. Thereafter interests in the production of the well were: C. C. Julian, 41 2/3 percent; petitioner, 38 percent; and Santa Fe Springs Oil Co., 3 2/3 percent. As of January 1931



petitioner was in possession of and operating the well.

All of the wells hereinbefore described were purchased by R. L. Mack in an execution sale held to satisfy a judgment in the amount of \$10,925.98 obtained by one Garliepp against C. C. Julian in 1929. The purchaser conveyed his interest by deed to W. A. Schwartz, who thereupon claimed to be the owner of the wells except for the royalty interests.

In about January 1931 C. C. Julian instituted suit in the Superior Court of California to restrain Schwartz from taking possession of the wells. The holders of participating oil agreements in Wells Nos. 1, 2, 3, and 11 filed a cross-complaint in the action, wherein they claimed to be the owners of the interests assigned to them and also claimed that Wells Nos. 16 and 17 were wrongfully producing oil from Wells Nos. 1, 2, 3, and 11. On March 19, 1931, the court appointed two individuals as receivers to operate the wells under existing leases, sell the production of the property, paying therefrom royalties and expenses incident to the receivership and the operation of the wells, and retain other funds until further order of the court. In April 1931 the court discharged one of the receivers. On March 23, 1932, pursuant to a stipulation of all of the parties to the action, the court appointed two trustees to operate the wells, but continued the receivership for the purpose of carrying on the litigation. Judgment was entered in the case on September 7, 1933. The court held that petitioner and J. A. Smith were each entitled to an undivided one-

half interest in Well No. 16, subject to the terms of the lease entered into on March 9, 1928. The judgment was affirmed by the District Court of Appeal, August 28, 1936, 16 Cal. App. (2d) 310; 60 Pac. (2d) 887. The case was finally determined on October 28, 1936, upon the denial of a hearing by the Supreme Court of California. While the proceeding was pending the wells were in possession of and being operated by receivers and/or trustees, hereinafter referred to as trustees, under the direction of the court.

After the termination of the litigation, J. A. Smith, successor to Wm. M. Cady of the one-half interest in Well No. 16 originally held by C. C. Julian, presented a claim to petitioner for one-half of the funds accruing from production of Well No. 16 after the receipt by [183] petitioner of \$80,000 for drilling the well. The sum of \$16,500.10 was included in the amount paid by petitioner to H. B. Flesher upon the order of C. C. Julian. Petitioner conceded that the payments theretofore made to H. B. Flesher had been made in error and in 1936 paid the sum of \$16,500.10 to J. A. Smith in accordance with his demand. C. C. Julian died a suicide in China in 1934, leaving no estate.

Petitioner quitclaimed Well No. 16 to J. A. Smith on December 20, 1937, in accordance with a resolution of its board of directors held on that date.

The amount of \$16,500.10 was ascertained to be worthless and charged off in 1936.

On or about July 29, 1931, D. R. Morrow brought an action in the Superior Court of California

against petitioner, Guy L. Hardison, and W. J. Barnhart for an accounting of the affairs of petitioner; for an accounting to petitioner by W. J. Barnhart, general manager, and Guy L. Hardison, president of petitioner, for any and all profits, including secret profits, and for unlawful payments set forth in the complaint; contesting unlawful and excessive salaries paid to W. J. Barnhart and Guy L. Hardison, and for their removal as officers of petitioner; and for the appointment of a receiver to take charge of the affairs and assets of petitioner pendente lite. It was alleged in the complaint that W. J. Barnhart and Guy L. Hardison had caused to be paid to themselves and/or credited to them excessive salaries from about September 1928 in the amount of \$1,000 each per month. On the same day the court appointed Ralph S. Armour receiver for petitioner.

On July 29, 1931, there had been accrued on petitioner's books at the rate of \$1,000 per month to July 31, 1931, as "accrued payroll" payable to Guy L. Hardison, the sum of \$14,000. There was also recorded on petitioner's records as due to Guy L. Hardison on July 31, 1931, the sum of \$8,500, represented by two notes payable. This liability arose out of a purported sale by Guy L. Hardison to petitioner of certain oil well equipment in connection with Well No. 17.

The questions relating to the salary of \$14,000 accrued in favor of Guy L. Hardison and the notes in the amount of \$8,500 were not settled until December 11, 1936, when the board of directors of

petitioner authorized the payment of \$7,000 to him for salary to December 30, 1930. At that time Guy L. Hardison admitted that the salary accrued in his favor was excessive. The remainder of the salary, being for the first seven months of 1931 during which petitioner's affairs were in the hands of a receiver appointed in connection with the Julian v. Schwartz litigation, was not recognized or paid. Such salary was written off in 1936 as of 1931 and credited to surplus. [184]

The net income or net loss of petitioner each year from 1930 to 1935 was as follows:

	Net Income	Net Loss
1930 .....	\$3,175.54	.....
1931 .....	.....	\$90,116.67
1932 .....	.....	5,213.85
1933 .....	666.27	.....
1934 .....	.....	2,516.00
1935 .....	.....	6,063.64

In accordance with instructions of the court, the trustees kept a record of the income and operating expenses of each well. On July 23, 1934, the court issued an order directing the trustees to pay from funds in their possession certain amounts, including \$102,885.93 to petitioner. The court order was ineffective during the pendency of the appeal in the Julian v. Schwartz litigation. It became effective on October 28, 1936, when the case was finally determined and adjudicated. The amount of cash distributed to petitioner in 1936 pursuant to the order was \$112,000. In 1937 petitioner received the additional sum of \$121,037.94 from the trustees pursuant to a court order entered in February 1937.

The trustees paid the sum of \$17,852.13 to the receiver in 1936 for the account of petitioner.

In or about February 1937 the trustees made a report to the court of their records and accounts for the period December 1, 1930, to November 30, 1936. The accounting was approved by the court on October 19, 1937.

Ralph S. Armour, receiver, was never in complete charge or control of the assets of petitioner, as the oil wells at Santa Fe Springs were in control of and being operated by the trustees.

The balance sheet of the petitioner at the close of the years 1930 to 1934, inclusive, shows deficits as follows:

1930 .....	\$ 70,486.41
1931 .....	160,603.08
1932 .....	165,816.93
1933 .....	163,582.01
1934 .....	166,098.01

The balance sheet of petitioner at the close of 1935 was as follows:

ASSETS	
Supplies .....	\$ 594.09
Capital assets:	
Leasehold interests .....	\$224,251.92
Oil well machinery and equipment....	60,568.15
Intangible oil well costs.....	60,908.31
Automobiles and trucks .....	443.73
Office furniture and fixtures .....	811.50
	<hr/>
	346,983.61
Less reserve for depreciation and depletion .....	99,979.87
	<hr/>
	\$247,003.74

[185]



Patents .....	1,000.00
Good will .....	26,224.21
Capital stock issued for services and leases.....	219,120.50
Organization expense .....	42,488.53
Accounts receivable .....	35,507.19
	<hr/>
Total.....	571,938.26
	<hr/> <hr/>

LIABILITIES

Notes payable .....	\$ 3,000.00
Accounts payable .....	17,267.70
Accrued expenses:	
Interest .....	1,396.67
Taxes .....	1,051.66
Pay roll .....	14,078.00
Due to stockholders .....	6,995.63
	<hr/>
Total liabilities .....	43,789.66
Deferred credits .....	5,333.25
Capital stock .....	694,977.00
	<hr/>
Surplus (deficit) .....	(172,161.65)
	<hr/>
Grand total .....	571,938.26

The assets shown in the balance sheet as capital assets, except a well known as the Hartley Well (not carried as an asset after 1930), and office furniture and fixtures shown in the books after 1931 at a value of \$811.50, were not in the possession of petitioner from the time of the appointment of the receiver in 1931 until the final determination of the Julian v. Schwartz litigation in 1936, but were in the possession of the receiver in that litigation and were being claimed by Schwartz and the holders of participating oil agreements as asserted in the proceeding. The financial condition of petitioner remained about

the same from January 1, 1936, until the receipt in November 1936 of funds from the trustees.

The income and expenses of petitioner for 1936 were as follows:

#### INCOME

Oil and gas sales after November 1, less expenses.....	\$ 6,436.30
Rental on drilling equipment .....	5,000.00
Distributions from trustees .....	142,989.99
Claim for interest relinquished .....	391.67
	<hr/>
	154,817.96
	[186]

#### EXPENSES

Interest paid .....	\$ 1,409.36
Loss, erroneous payments to J. A. Smith .....	16,500.10
Receivership expenses .....	17,574.68
	<hr/>
	\$ 35,484.14
	<hr/>
Net income .....	119,333.82

None of the income impounded by the trustees in the Julian v. Schwartz litigation was considered as income to petitioner until released to it. In and after 1933, pursuant to a stipulation filed with the court in 1933, there was released to J. A. Smith for the account of petitioner proceeds of gas production of Wells Nos. 1, 2, 3, and 11 accruing to petitioner. At a hearing held in Washington, D. C., on August 13, 1937, these amounts were determined to have been constructively received by petitioner in 1933 and years subsequent thereto. There was deducted from such income depreciation on the tangible equipment of the wells and other tangible lease equipment which was then being used by the trustees. In addition to the depreciation so deducted, there was deducted and allowed business expenses

paid and accrued, including legal fees and receivership expenses. The receivership expenses so allowed were allowed as deductions in and for the years for which they were definitely determined and approved by the court.

On November 12, 1936, Ralph S. Armour, receiver, filed with the court a final account and report showing that during the period of the receivership he had incurred expenses, aggregating \$17,852.12, as follows:

1931 Auditor's services .....	\$ 125.00	
Appraisers' fees .....	300.00	
Stationery .....	13.00	
Notarial fee .....	.85	
Advertising sale of equipment.....	12.00	
	<hr/>	\$ 450.85
1932 Telephone .....	73.57	
Rent .....	302.50	
Towel service .....	5.50	
Auditors' services .....	1,750.00	
Typewriter repairs .....	2.90	
Loan by receiver to pay tele- phone bill .....	27.45	
Insurance, Wells Nos. 16 and 17.....	108.53	
Attorneys' fees .....	480.00	
	<hr/>	2,750.45
1933 Bond, Hartley Well No. 1.....	100.00	
	<hr/>	100.00
1934 Typewriter repairs .....	12.50	
	<hr/>	12.50
		[187]
1936 Attorney's fees .....	\$6,920.00	
Receiver's bond .....	125.00	
Office rent, phone, etc., pro rata.....	1,100.00	
Receiver's fees .....	6,393.32	
	<hr/>	\$14,538.32
Total.....		<hr/> 17,852.12

The court approved the account the day it was filed. In its order approving the account, the court said:

\* \* \* it appearing to the court that defendant, Barnhart-Morrow Consolidated, a corporation, is no longer insolvent by reason of its success in the litigation entitled: Julian v. Schwartz, No. 315-345, in this court, now finally determined on appeal, and that by reason of the termination of said litigation and the present solvency of said corporation, there is no longer any reason for the continuance of said receivership herein. \* \* \*

and directed that the receiver's expenses be paid out of the first moneys accruing and paid to petitioner.

The petitioner's share of the gross proceeds of production of Julian Wells Nos. 1, 2, 3, 11, 16, and 17 for the period December 1, 1930, to November 14, 1936, during which time the wells were in possession of and being operated by the trustees, was \$488,903.65. The total charges made against petitioner by the trustees for the operation of the wells during that period were \$223,352.83, leaving a balance of \$265,550.82 payable to petitioner. Of the net amount of impounded funds due petitioner, \$142,989.99 was paid to it in 1936, \$122,371.37 in 1937, and the balance of \$189.46 in subsequent years. The payment made in 1936 consisted of the following items: cash paid to Ralph S. Armour, receiver, for receivership expenses, \$17,852.13; cash to petitioner, \$112,000; depreciated cost of well equipment acquired by trustees and delivered to petitioner on November 14,

1936, \$7,992.90; compensation insurance, \$300; liabilities of petitioner paid by trustees, \$4,844.96.

The petitioner sustained an operating loss of \$3,258.78 in the operation of Well No. 16 in 1937 up to the time it ceased producing because of unknown damage to the well. Work of an undescribed nature on the well was necessary to ascertain the kind and extent of the damage and the cost of making repairs. J. A. Smith, the owner of the other one-half interest in the well, including its equipment, was not liable for more than \$250 per month for operating expenses of the well.

The terms of the United lease required petitioner to operate Well No. 16 even though in doing so it sustained a loss, and in the event that petitioner abandoned the well the lessor had the right to take possession thereof, including its equipment, and hold or operate the property at its own expense, free from any claim of the petitioner, subject, however, to a royalty of  $8\frac{1}{3}$  percent to petitioner. In case the lessor did [188] not exercise the right to take over any abandoned well, petitioner was obligated to restore the premises to their original condition, including the plugging of the well in accordance with the laws of California. The cost of plugging a well is from \$5,000 to \$10,000. The well had some salvage value, probably \$2,000.

In December 1937 Harold G. Morton, an experienced oil operator and counsel, and a director and stockholder of petitioner, suggested to the board of directors of petitioner that the well be abandoned. At that time J. A. Smith held about 35 percent of



petitioner's stock and Harold G. Morton and another individual each held about 9 percent. The remainder of the stock was widely distributed. On December 20, 1937, the board of directors of petitioner adopted a resolution to surrender the well, and the premises pertaining thereto, to J. A. Smith and executed a quitclaim deed for the property in his favor.

Work done on the well immediately thereafter by J. A. Smith revealed that the liner thereof had crumpled. The damage was repaired at a cost of about \$800. The well sustained similar damage in 1936 and was repaired at a cost of about \$18,000.

The well was placed on production in January 1938, in which month it produced oil and gas of a value of about \$1,500. The gross production of the well was increased to \$2,550 in April 1938, and thereafter it decreased to \$700 or \$800 in October 1941.

## OPINION

### Bad Debt Issue

Disney: The respondent disallowed the item of \$16,500.10 as a bad debt deduction upon the ground that the debt was not ascertained to be worthless and charged off during the taxable year. The substance of respondent's argument upon brief is that the promise of C. C. Julian ceased to have any value in 1934, when he died leaving no estate, and that the "loss", if any, was sustained in that year.

It was stipulated that the amount was charged off in 1936, leaving for decision only the question of whether the debt was ascertained to be worthless

in the same year. Both parties refer to the undertaking of C. C. Julian as a contract of indemnity and we will assume that it was such an agreement. Under it the indemnitor obligated himself to reimburse petitioner in the event petitioner was compelled to pay to another any amount paid to him or his agent under his claim of right to receive a portion of the proceeds of production of Well No. 16. This promise did not ripen into a claim against the indemnitor until 1936, when the courts of California decided that J. A. Smith was the owner of the interest under which C. C. Julian's nominee had received the sum in question. *Howell v. Commissioner*, 69 Fed. (2d) 447. Thus [189] there was not at any time prior to 1936 a debt against C. C. Julian to ascertain to be worthless. When it did come into existence, it was worthless and petitioner so ascertained it. Then, for the first time, there was a debt to collect, and if ascertained to be worthless, to charge off as uncollectible.

Respondent cites no authority for his statement that the obligation of C. C. Julian was discharged by his death. We find none. It was not a personal covenant, incapable of being performed by any other person. On the contrary, his obligation was one which survived him and for which his estate was liable. *Elliott v. Garvin*, 166 Fed. 278; *Brownfield v. Holland*, 63 Wash. 86; 114 Pac. 890. His estate was insolvent when the debt came into existence. We hold that the petitioner is entitled to deduct the amount in controversy as a debt ascertained to be worthless and charged off in 1936.

## Salary Issue

The respondent makes the general contention under the second issue that, where salary is accrued and deducted from income and the liability is satisfied in a subsequent year for less than its face amount, the difference between the liability and the amount for which it was satisfied constitutes taxable income. The rule laid down by the Board in and since *Central Loan & Investment Co.*, 39 B.T.A. 981, has been that such an amount is not income unless the deduction made in a prior year served to offset taxable income. *Estate of James N. Collins*, 46, B.T.A. 765; *Estate of Charles H. Robinson*, 46 B.T.A. 943; *Citizens State Bank*, 46 B.T.A. 964.

Here the petitioner had a net loss in 1931 of \$90,116.67 and no contention is made that the compensation canceled in 1936 was not deducted in arriving at the net loss. Accordingly we sustain the petitioner on this issue.

## Insolvency Issue

In his determination of the deficiency for 1936 respondent held that petitioner was not insolvent at any time during the period of its receivership in that year and therefore was not exempt from surtax on \$89,476.51 of undistributed net profits under the provisions of section 14 (d) (2) of the Revenue Act of 1936.<sup>1</sup> [190]

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<sup>1</sup>Sec. 14. Surtax on undistributed profits.

\* \* \* \* \*

(d) Exemption From Surtax. The following cor-

The difference between the parties is whether petitioner was insolvent in 1936 during the period of receivership. They agree that if it was insolvent at any time during that period the statute exempts petitioner from surtax.

In *Artesian Water Co.*, 43 B.T.A. 408, we said that the word "insolvent" as used in section 14, *supra*, "was intended by Congress to carry the meaning used" by the Supreme Court in *Dutcher v. Wright*, 94 U.S. 553. In that case the Court said that "Insolvency, in the sense of the Bankrupt Act, means that the party whose business affairs are in question is unable to pay his debts as they become due, in the ordinary course of his daily transactions." We thought this was evidenced by the Senate Finance Committee Report on the provision, in which the committee said:

The Finance Committee Bill also avoids the possibility of tax avoidance by collusive Receiverships by limiting the provision to cases in which the corporation is in bankruptcy under the Federal bankruptcy laws, and to cases in which it is insolvent, i.e., its liabilities are in excess of its assets or it is unable to pay the claims of creditors as they mature—and in receivership in Federal or State Courts.

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porations shall not be subject to the surtax imposed by this section:

\* \* \* \* \*

(2) Domestic corporations which for any portion of the taxable year are in bankruptcy under the laws of the United States, or are insolvent and in receivership in any court of the United States or of any State, Territory, or the District of Columbia.

In holding that the petitioner did not come within the exemption provided by the statute, we referred to proof that during the taxable year its assets were about ten times its liabilities, exclusive of capital stock and surplus, and that it had made payments on some of its obligations.

Regulations 94, promulgated for the Revenue Act of 1936, does not define the meaning of insolvent. See art. 14-1. Article 13-4 of Regulations 101, Revenue Act of 1938, defines the term insolvent as meaning "insolvency in the sense of excess of liabilities over assets and in the sense of inability to meet obligations as they mature."

Regulations 103, applicable to the Internal Revenue Code, defines the term insolvent as meaning "insolvency either in the sense of excess of liabilities over assets or in the sense of inability to meet obligations as they mature." Sec. 19. 13-4. A definition that "insolvency is established if liabilities exceed assets or if the debtor corporation is unable to meet its obligations" was agreed upon by the parties in *United States v. Anderson*, 119 Fed. (2d) 343. In that case the court said that in determining insolvency "the court should allow for reasonable use of the debtor's credit."

The United States Circuit Court of Appeals, in reversing *Artesian Water Co.*, *supra*, said that as the taxpayer's assets exceeded its liabilities and it was not, therefore, insolvent in a bankrupt sense, solvency or insolvency turned upon whether "the taxpayer was able to meet its obligations as they matured, in the usual course of trade or business."



125 Fed. (2d) 17. It decided that the taxpayer was unable to meet its [191] obligations, "either from its current assets or with 'the reasonable use of the debtor's credit' (United States v. Anderson Co., supra.)"

We think a corporation is insolvent within the meaning of section 14 (d) (2), supra, if at any time during receivership it is unable to meet its obligations as they mature in the ordinary course of business, with a reasonable use of its credit.

All of petitioner's oil and gas property was in the possession and control of trustees appointed by the court in the Julian v. Schwartz litigation. The remaining assets were in the possession and control of a receiver appointed in the litigation instituted by D. R. Morrow in 1931. The balance sheets of petitioner at the close of the years 1932, 1933, 1934, and 1935 reflect, exclusive of the oil and gas properties, no cash on hand. Other assets on which something might have been realized consisted of supplies in the amount of \$594.09, patents \$1,000, stock issued for service and leases \$219,120.50, and accounts receivable of \$35,507.19. Its liabilities, consisting of notes and accounts payable, accrued expenses and amounts due stockholders, were \$55,611.12, \$43,580.75, \$43,111.14, and \$43,789.66, respectively, at the close of 1932, 1933, 1934, and 1935. The balance sheets of petitioner as of the termination of the receivership and at the close of 1936 were not introduced in evidence. Testimony, however, established that there were no substantial changes before the termination of the receivership in 1936.

Though the final accounting of the receiver disclosed obligations incurred as early as 1931, the record does not disclose whether any of the debts shown by the balance sheets, except salary accrued in 1931 in favor of Guy L. Hardison in the amount of \$14,000, but which was involved in the litigation instituted by D. R. Morrow in 1931, matured during the receivership. No evidence was offered as to the arrangements made, if any, with the creditors for payment of these debts.

The burden was on petitioner to establish its insolvency and any deficiency of proof must operate against it. No attempt was made to show inability to meet maturing debts by a reasonable use of credit. It is true that the oil and gas properties were in the possession and control of the trustees and for that reason could not have been used by the receiver as collateral for a loan, but he had under his control stock of a book value of about \$220,000. Nothing of record is opposed to the idea that this stock could have been used as security for a loan or sold to pay debts. Neither does it appear that an application was ever made to the court for permission to sell receiver's certificates or otherwise raise funds to meet matured obligations.

We do not regard as helpful to petitioner the statement appearing in the court order of November 12, 1936, that petitioner was no longer [192] insolvent by reason of the litigation. It does not appear that the court ever had before it the question of solvency or insolvency of petitioner. Neither does it appear that any of the parties in interest ever al-

leged such a fact in pleadings before the court. On the contrary, the complaint filed by D. R. Morrow, which resulted in the appointment of the receiver, alleged, among other things, that the corporation had been in a prosperous condition and was then operating at a profit, but that the profits were being diverted from the stockholders and petitioner. The receiver does not appear to have received any funds until the latter part of 1936, when his expenses were paid out of receipts from the trustees, but inability to pay due to impounding of assets in a receivership, not based upon grounds of insolvency, is not proof of insolvency in the sense of inability to meet maturing debts. The receivership of itself does not prove insolvency.

The petitioner has failed to prove that it was insolvent at any time during the period of receivership in 1936. Accordingly we sustain the respondent on this issue.

#### Depletion Issue

In his determination of the deficiency for 1936 respondent allowed depletion on \$122,371.37, representing the amount received by petitioner in cash and credits in that year out of the funds impounded by the trustees in the Julian v. Schwartz litigation. He contends here that that amount constitutes petitioner's gross income and net income during the taxable year from the operation of the wells by the trustees. Petitioner contends that it is entitled to depletion on not only the \$122,371.37 thus received, but on the additional amount of \$223,352.83, representing expenses incurred by the trustees in the

operation of the properties, all of which was chargeable to and charged to petitioner. Thus petitioner seeks depletion on \$366,342.82 and respondent asks us to restrict it to the net amount. The facts are not in dispute. Depletion on the production of the wells in 1936 after petitioner acquired possession of the wells and in 1937 is not in controversy.

Petitioner insists that its economic interest in the production of all of the wells was \$488,903.65 and that it could not actually or constructively receive the net economic interest of \$265,550.82 (\$488,903.65 less operating expenses of \$223,352.83) without constructively receiving the \$223,352.83 charged to it for operating expenses.

The parties agree that under the rule of *North American Oil Consolidated v. Burnet*, 286 U. S. 417, no part of the proceeds of production constituted taxable income to petitioner until received by it. They also reached an agreement in 1937 that no income tax liability would be assessed against the trustees for the years 1931 to 1936, but [193] that the recipients of the proceeds of production would be liable for income taxes in the year or years in which the funds were distributed.

We think the question is controlled by *Crews v. Commissioner*, 89 Fed. (2d) 412, affirming, on the point involved herein, 33 B.T.A. 441.<sup>2</sup> In that case in 1922, while certain litigation relating to failure to drill offset wells was pending, the lessors of oil prop-

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<sup>2</sup>For a complete history of the proceeding see also 30 B.T.A. 615; 31 B.T.A. 187; 37 B.T.A. 387; 108 Fed. (2d) 712; 120 Fed. (2d) 749; 33 B.T.A. 36.



erty entered the undeveloped section of the leased land and began development thereof. The Sinclair Oil & Gas Co., operator of the developed portion of the property as assignee of the lease, served notice that it claimed a right to such production as might be obtained by the lessors. To provide an outlet for their production, the lessors entered into an escrow agreement under the terms of which seven-eighths of the proceeds of production was to be deposited in escrow in a bank, subject to payment to the proper parties in interest when the litigation was settled, the escrow agent to pay to the lessors in the meantime such sums out of the escrow funds as were necessary for them to use in further developing the land. The litigation was settled in October 1930. Prior thereto there was expended out of the escrow funds the sum of \$849,544.37 for drilling, equipping and operating wells and for miscellaneous purposes incident to the production of oil and gas. While this arrangement was in effect the lessors produced from the property entered by them oil and gas in the amount of \$1,462,504.02. Aside from the moneys expended for development and operating purposes, no part of the escrow funds was actually paid to the lessors, due, among other things, to misappropriation of funds by officials of the bank and worthlessness of an indemnity agreement executed in connection with the matter and the giving of a release by the lessors in favor of the bank.

The question involved in the proceeding was the amount of depletion to which the lessors were entitled, in connection with which it was necessary to



determine the amount of gross income from the property. We held that gross income from the property was \$1,462,504.02 less \$514,000 representing bonds purchased with escrow funds by the bank, no part of which, however, was ever received by the lessors, plus \$355,000 received from Sinclair in 1930, the taxable year, in settlement of the litigation, a total of \$1,303,504.02. Upon appeal the court held that the gross income from the property was \$1,204,544.37, being \$849,544.37 plus \$355,000. Subsequent consideration of the proceeding by this Board and the Circuit Court of Appeals did not in any wise alter the conclusion thus reached that upon settlement of the litigation and the termination of the escrow agreement in 1930, the taxable year, the amount of \$849,544.37 paid out of pro- [194] duction for development and operating purposes constituted gross income.

In that case, as already indicated, there was nothing in the escrow fund in 1930 to pay over to the lessors. Hence none of the proceeds of production were actually received, except for the \$849,544.37 expended for development and operating purposes. Here the proceeds of production during the pendency of the Julian v. Schwartz litigation were in excess of operating expenses paid by the trustees out of production and upon the final termination of the litigation in 1936 only a part of the net proceeds was paid to petitioner. We do not think this point of difference in the facts of the two proceedings requires a different conclusion. The expenditures were made out of production of oil and

gas for the benefit of petitioner. Under *North American Oil Consolidated v. Burnet*, 286 U. S. 417, we must consider the petitioner as having received no income until its right thereto was determined and receivership terminated, which was in 1936, and that the fact that the money was earned in previous years does not control; and the *Crews* case applies the principle there enunciated squarely to gross income, arising from oil production in years earlier than the year of receipt, for the purpose of computing depletion. This is consistent with the agreement of the parties that taxation would fall in the years when the funds were distributed. We hold the item of \$223,352.83 to be gross income in 1936 from the property and that the Commissioner erred in refusing to allow petitioner depletion thereon. Depletion will accordingly be recomputed on the basis of \$488,903.65 as the gross income from the property, the amount of depletion on the entire property for the year 1936 not to exceed, however, 50 percent of the net income from the property. There appears to be no difference of opinion between the parties on the facts necessary to compute the net income from the property.

#### Loss, Well No. 16, Issue

The respondent is contesting the allowance of petitioner's claim for a loss of \$43,151.96 upon the relinquishment in 1937 to J. A. Smith of its one-half interest in Well No. 16 upon the ground that the petitioner has failed to prove the cost or other basis of the property. Petitioner relies upon its Exhibit No. 57 to establish the amount of its loss.

This exhibit is a statement prepared from petitioner's books showing entries made therein for the cost of tangible well equipment, less depreciation, and intangible drilling cost, less depletion and depreciation on drilling equipment.

In his determination of the deficiency the respondent disallowed a loss of \$38,984.02 claimed by petitioner in its return upon the ground that the alleged loss did not fall within the provisions of [195] section 23 of the Revenue Act of 1936. During the course of the hearing in this proceeding respondent's counsel announced that the amount of the loss was in dispute. Exhibit No. 57 was offered by the petitioner "for the purpose of showing the method and the manner in which petitioner arrived at the figure of \$43,151.96 \* \* \* and not for the purpose of showing that it is evidence of the fact that they did sustain that, but to show how we arrived at that figure, to show our method of computing." Counsel for the respondent objected to the introduction of the document in evidence "in the form offered as being immaterial." The objection was overruled and the exhibit was admitted in evidence "for the purpose stated by counsel."

The method employed in determining the amount of a loss is not in every instance proof of cost or other basis. It does not prove the cost in this proceeding. Respondent never agreed that petitioner's books reflected actual cost of the well. Petitioner deducted from the book costs of tangible equipment a total of \$17,889.48 for depreciation. Whether this amount represents the "amount allowed (but not

less than the amount allowable)" within the meaning of section 113 (b) (1) (B) of the Revenue Act of 1936 does not appear. Depreciation in the amount of \$3,604.26 on drilling equipment was included in a total of \$74,167.31 for intangible drilling costs. No evidence was offered to prove whether the item of \$3,604.26 represents the correct figure for depreciation and the record is void of any evidence to show that these intangible drilling costs were not deducted as ordinary and necessary business expense in the year in which they were incurred, as permitted by article 243, Regulations 74. The balance sheet as of the close of 1935 has an item of \$60,568.15 for intangible drilling costs of the well, but that does not, without more, prove that petitioner has not had tax benefit from the expenditure. No allowance was made by petitioner in the computation for the salvage value of the well.

The evidence of record fails to prove the amount of any loss sustained by petitioner in connection with the transfer of its interest in Well No. 16. Accordingly we sustain the respondent on this issue.

Decision will be entered under Rule 50. [196]

[Title of Board and Cause.]

MOTION AND APPLICATION FOR RECON-  
SIDERATION OF DECISION OR RE-  
HEARING AND FOR ADDITIONAL FIND-  
INGS

Barnhart-Morrow Consolidated, Petitioner herein, now respectively moves the Board for a reconsideration of the decision in this matter promulgated August 20, 1942, or for a rehearing of this matter, and that additional findings be made.

This Motion and Application is upon the grounds that the decision with respect to two of the issues here involved inadvertently misconceives the purport of the testimony in the record and inadvertently fails to give consideration to stipulated facts in the record and is contrary [198] to stipulated facts and the undisputed testimony with respect to such two issues. Said grounds of this Motion and Application will be more particularly detailed in the consideration herein of each of the two issues as to which the decision is by Petitioner claimed to be so erroneous.

Further, the findings on one of the other issues are incomplete with respect to the income of Petitioner as to each of the wells for the years 1936 and 1937, and additional findings are now requested to be made to cover said matter, as hereinafter more fully set forth.

PRELIMINARY STATEMENT

This matter was submitted largely on a lengthy Stipulation of Facts, which Stipulation of Facts



incorporated a total of fifty-four (54) exhibits. The Stipulation of Facts was supplemented by oral testimony and additional exhibits. There were five issues submitted for determination, three of which issues were determined in favor of Petitioner. Two of the issues were determined favoring the contentions of the Respondent and against the contentions of Petitioner. As to such latter two issues, we sincerely urge that the decision is contrary to the undisputed proof, both in the Stipulation of Facts and the oral testimony. The Stipulation of Facts is incorporated in the findings, and certain of the stipulated facts being contrary to facts recited in the Opinion, we present this Motion and Application. [199]

### LOSS, WELL No. 16, ISSUE

With respect to the Loss, Well No. 16, Issue, the Opinion determines the issue against Petitioner, stating that the evidence fails to prove the amount of any loss sustained by Petitioner in that the Petitioner failed to prove the cost of Well No. 16.

The Opinion then refers to Exhibit No. 57 and states that said exhibit was offered by Petitioner:

“ \* \* \* for the purpose of showing the method and the manner in which petitioner arrived at the figure of \$43,151.96 \* \* \* and not for the purpose of showing that it is evidence of the fact that they did sustain that, but to show how we arrived at that figure, to show our method of computing.”

(Opinion, page 17).

The objection of materiality to this exhibit was overruled and it was admitted:

“ \* \* \* for the purpose stated by counsel.”

The Opinion then states:

“The method employed in determining the amount of a loss is not in every instance proof of cost or other basis. It does not prove the cost in this proceeding.”

The undisputed proof in the case shows that Exhibit No. 57 gives the detail of the cost of Well No. 16, as we will shortly hereinafter show; however, another exhibit, part [200] of the stipulated facts, to wit, Exhibit No. 51, sets forth the cost of Well No. 16, both tangible and intangible. Reference to said Exhibit No. 51, which by Paragraph XXXVI of the Stipulation of Facts is stipulated to be the Balance Sheet of Petitioner as per its books for the years 1930 to 1935, shows under the caption “Capital Assets” the name of the account on the books of Petitioner as “Oil Well Machinery and Equipment”, and immediately below it, Santa Fe Springs Wells Nos. 1, 2, 3, 11, 16 and 17, and represents all of the tangible equipment costs with respect to those wells. Under the account name “Intangible Oil Well Costs” (a sub-head under “Capital Assets”) appearing on said Exhibit No. 51, there immediately follows below it “Santa Fe Springs Well No. 16”, showing that the Petitioner had capitalized on its books the intangible drilling costs of Well No. 16, which at December 31, 1935 amounted to \$60,908.31. (The Opinion herein er-

roneously states that such intangible costs were \$60,568.15, which amount in fact represents the tangible equipment costs of Wells Nos. 1, 2, 3, 11, 16 and 17.) The difference in the Intangible Development Cost of Well No. 16 as at December 31, 1935 of \$60,908.31 (Exhibit No. 51) and the amount of intangible cost as at December 20, 1937 of \$74,167.31, as set forth on Exhibit No. 57, represents the intangible costs of reconditioning Well No. 16 when the casing and tubing collapsed in March, 1937. Note then the uncontradicted proof [201] was that approximately \$14,000 of the intangible expense was in the year 1937, the year here under review.

The Opinion herein has referred to the intangible expense, stating:

“ \* \* \* the record is devoid of any evidence to show that these intangible drilling costs were not deducted as ordinary and necessary business expense in the year in which they were incurred, as permitted by article 243, Regulations 74.”

This overlooks the fact that the stipulated Exhibit No. 51 shows that the intangible drilling costs were not charged off as expense, but capitalized. Said Exhibit No. 51 shows the intangible drilling costs being carried on the books of the Petitioner as a capital asset.

In this proceeding Respondent has not claimed at any time that Petitioner had expensed its intangible drilling costs or in any manner had a tax benefit from such expenditures. This, of course, is

for the very obvious reason that Respondent had stipulated that Exhibit No. 51 was a correct balance sheet and it shows the intangibles on this well to have been capitalized. Respondent also was fully aware, through audits and investigation of Petitioner's tax returns, that Petitioner has never expensed such items, and in prior income tax returns filed by Petitioner with Respondent no deduction for intangibles had been taken as expense items from the time the well was drilled until the same was abandoned, and it was only upon the [202] abandonment loss in 1937 that the amount of such intangibles was claimed as a loss, that being the very item involved in this proceeding. Also, as stated, approximately \$14,000 of this intangible expense was in the year 1937, the year under review.

With respect to Exhibit No. 57, the undisputed testimony of Mr. Geo. F. Meitner, a Certified Public Accountant, was that the figures thereon came from the original books and records of Petitioner. Such original books and records of Petitioner were actually present at the hearing before the Board; being large and bulky, they, of course, were not introduced in evidence, but instead figures were taken therefrom placed in a schedule and offered in evidence. Mr. Meitner, after testifying as to his familiarity with the books and records of Petitioner and the fact that the originals were in Court, testified:

“Q. (By Mr. Burkhead.) May I ask the witness to point out to me the statement which

I think you have prepared showing that \$42,000 item that is claimed as a loss on that well?

A. On the same statement?

(Referring to Well No. 16)

Q. Can you state briefly how the figure of \$43,151.96 claimed as a loss on Well 16 was arrived at and established?

Mr. Tonjes: Claimed as a loss on what?

Mr. Burkhead: On the abandonment of Well No. 16. [203]

Mr. Tonjes: In the petition?

Mr. Burkhead: That is right.

The Witness: Well, from the books of the corporation I prepared this agreement—this exhibit, showing tangible well equipment of \$26,890.37, less the cost of casing and tubing collapse at March, 1937, of \$5,959.12, making the net original return for well equipment cost as set up on the records \$20,931.25.

Q. (By Mr. Burkhead.) Maybe I can shorten this. Is this tabulation that I hand you now, does it reflect the figures and the manner in which you arrived at that figure, total figure of \$43,151.96? A. It does.

Q. And the figures appearing on this statement, did you take those from the books of Barnhart-Morrow Consolidated?

A. I did."

Counsel for Respondent then cross-examined Mr. Meitner on this figure of \$43,151.96 he claimed loss on this transaction, as follows:



“Mr. Tonjes: Might I ask the witness a question or two?

Mr. Burkhead: Yes.

Mr. Tonjes: Mr. Meitner, in determining this figure of \$43,151.96, you obtain all these figures from the books of Barnhart-Morrow?

The Witness: Yes, I believe I have got all the figures set up there at the time I made the audit.

Mr. Tonjes: Did some of the figures come from the books of the trustee?

The Witness: No, they didn't.

Mr. Tonjes: You state that there has been claimed a deduction for depletion on December 31, 1935, in the amount of \$28,472.01. Where did you get that figure? [204]

The Witness: That is on the books of the corporation.

Mr. Tonjes: What does it represent?

The Witness: It is depletion that had been accrued on production in prior years up to December 31, 1935, referring to that \$28,472.01.

Mr. Tonjes: That depletion represents depletion during the period in which the trustees operated the wells?

The Witness: No. That practically represents the depletion up to the time that the wells were taken over by the trustees. In other words, it is in the early years of production of Well No. 16.

Mr. Tonjes: That is depletion sustained prior to the time the trustees took over the operation of the wells?

The Witness: That is correct.

Mr. Tonjes: And do you know whether or not that corresponds with the depletion figure deducted from the income tax return for this corresponding period?

The Witness: Yes, I do.

Mr. Tonjes: Did you check that?

The Witness: Yes, I did. In other words, in my conference back in Washington it may be that this might have a little depletion with respect to gas production of well—no, because Well 16 wasn't involved in that. This is all prior to the time the receivers took over the operation of that well.

Mr. Tonjes: And the two figures immediately following, depletion on Olson and Smith distribution of 1936 of 9400 and eight thousand odd dollars, how did you ascertain that figure? [205]

The Witness: Those were calculated by me on the amount of gross proceeds of the oil which had been credited the Barnhart-Morrow by Olson and Smith in the report that I prepared for that receivership.

Mr. Tonjes: In other words, that represents depletion?

The Witness: As I calculated it.

Mr. Tonjes: For a period during which Barnhart-Morrow did operate the wells?

The Witness: That is right.

Mr. Tonjes: I have no further questions."

Mr. Tonjes thus established that all the depletion to be credited on the intangible drilling cost on this well had been computed and appeared on the records of the Petitioner. Mr. Tonjes, of course, knew that Petitioner had not expensed intangibles or this examination would have been entirely different. Mr. Tonjes was very properly making sure that the total depletion to be deducted from the intangible cost was set forth on Exhibit No. 57.

The Exhibit No. 57 to which Mr. Meitner had been referring was then offered in evidence, counsel stating that it was offered by Petitioner:

" \* \* \* for the purpose of showing the method and the manner in which petitioner arrived at the figure of \$43,151.96 \* \* \* and not for the purpose of showing that it is evidence of the fact that they did sustain that, but to show how we arrived at that figure, to show our method of computing."

Counsel for the Respondent objected to the introduction of the [206] document in evidence:

" \* \* \* in the form offered as being immaterial."

The objection was overruled and the exhibit was admitted in evidence:

" \* \* \* for the purpose stated by counsel.",  
such purpose being, as stated by counsel, to show how Petitioner arrived at the \$43,151.96 (the amount of the loss claimed). Said exhibit showed

that it was arrived at by taking the tangible well equipment cost, less certain theretofore allowed depreciation and other proper deductions, and the intangible drilling cost (which was detailed as to items), less depletion. It detailed the cost.

Exhibit No. 57 shows that casing and tubing had collapsed in said well as early as March, 1937, and Mr. Meitner testified to such collapse of casing and tubing. The cost of the casing and tubing which collapsed was \$5,959.12, and against which there had been provided for depreciation up to the time of the collapse of the tubing and casing in March of 1937, the sum of \$4,877.58, as shown on said Exhibit No. 57, leaving a loss sustained on the casing and tubing collapse of \$1,081.54. This loss was allowed by the Respondent as a deduction from income in the year 1937 as set forth on Exhibit No. 61 under the caption of "Expenses"—"Loss on Tubing Collapse" \$1,081.54 and the amount was extended under Well [207] No. 16 in said Exhibit No. 61. Depreciation was allowed by the Respondent on tangible oil well equipment on Well No. 16 for the year 1937, which depreciation allowance is reflected in Well Operating Costs and Maintenance, Exhibit No. 61. The depreciation so allowed, together with the depreciation allowed in prior years, was used in determining the loss sustained on the tubing collapse of \$1,081.54, and the loss sustained on the tangible equipment when the well was abandoned by the Petitioner in December 1937, and is as set forth in Exhibit No. 57.

Mr. Meitner testified with respect to depletion and to the effect that the sum of \$28,472.01 Depletion Reserve as at December 31, 1936, as set forth on Exhibit No. 57 was accrued on the books and on the production of Well No. 16 up to the time that the well was taken over by the trustees in the matter of Julian vs. Schwartz. Mr. Meitner further testified with respect to the depletion on Olson and Smith distributions in the years 1936 and 1937 and that the amounts of depletion of \$9,407.29 and \$8,050.80 for those years, 1936 and 1937, were "as I calculated it."

The amount of the allowance for depletion on the distributions received from Olson and Smith was one of the issues in this proceeding, and to the extent that the allowance for depletion as shown on the books of Petitioner and by Mr. Meitner placed on Exhibit No. 57, might be at variance [208] with the allowance for depletion determined in this proceeding for the years 1936 and 1937. As respects Well No. 16, the extent of the loss on abandonment of Well No. 16, as set forth on Exhibit No. 57, would be required to be adjusted. Actually, now that we have the decision on the depletion issue, the variance between the figures on Exhibit No. 57 and the decision herein actually involves only the sum of \$387.67.

The important thing about Exhibit No. 57 is that it sets forth the detail of the items of cost to Petitioner of Well No. 16, less the appropriate deductions. This was the "method" of establishing the



loss, that is, to show the cost to Petitioner of Well No. 16. The basis of the loss with respect to Well No. 16 on abandonment and quitclaim could only be the cost less deductions, such as were set forth and any possible salvage.

Further testimony as to the cost and basis of Petitioner's loss is the following testimony of Mr. Meitner which was unquestioned and undisputed in the record (Record, p. 60):

“Q. (By Mr. Burkhead): Mr. Meitner, will you state how the mechanics from a bookkeeping standpoint of this \$43,151.96 (loss) was reflected by you on the books of the corporation.

A. Well, an entry was made charging off the equity remaining balanced, the difference between the cost value of the tangible equipment and the intangible drilling cost of the well less the reserve for depreciation on the tangible equipment, and the depletion reserve on the intangible equipment to arrive at, charged off as a loss to profit and loss on the company's records.

Q. In the year 1937?

A. In the year 1937.” [209]

The Opinion states:

“No allowance was made by petitioner in the computation for the salvage value of the well.”

However, as the Opinion itself points out, the undisputed testimony was that the salvage amounted

to "probably \$2,000" and it was best to abandon such salvage rather than incur the expense of plugging the well, which would clearly exceed such salvage value. (Opinion, p. 10.)

After counsel for Petitioner and counsel for Respondent had worked out the long Stipulation of Facts herein, the Board Member asked counsel for a statement of position on each issue. On this Well 16 Issue counsel for Respondent did not question the correctness of the cost of the well as on the books of petitioner and presently appearing on the prepared schedules, but questioned this item on other grounds, the full statement of counsel for Respondent being as follows (Record, page 10):

"Another issue is the abandonment of Well No. 16. That, of course, is perhaps largely factual. We have stipulated that the property was quitclaimed, but there again it was quitclaimed to a stockholder of the organization, Mr. Smith again, and apparently there was no effort made to salvage any property or anything of that sort. It was just given to him, and respondent submits that under the circumstances, why, there is no deductible loss resulting, and if there is a loss at all, it is a capital loss and the capital limitation applies.

The Member: It was claimed as an ordinary loss?

Mr. Tonjes: I think it was, yes, your Honor." [210]

The evidence established the loss and disposed of the matters referred to by Mr. Tonjes.

The pleadings in this matter (Petition and Answer) establish that Exhibit A to the Petition is Respondent's notice of deficiency as to Petitioner's years 1936 and 1937, which deficiency gave rise to this proceeding. An examination of that document (Notice of Deficiency) shows at page 8 thereof, that the loss on Well 16 was disallowed "as not falling within the provisions of Section 23 of the Revenue Act of 1936." That section refers to Deductions from Gross Income. An examination of the deficiency notice shows that it was only written after a thorough and exhaustive examination of the records and documents pertaining to the various matters affecting the income and expense of Petitioner for the years 1936 and 1937. Nothing is therein stated about the failure of Petitioner to show the cost of Well 16, or Petitioner's inability to establish a basis for the amount of the loss on abandonment of Well 16. Had such been the case Respondent would have rejected the loss on that ground. [211]

### INSOLVENCY ISSUE

The other issue with respect to which Petitioner believes that the Opinion has misconstrued and overlooked undisputed evidence is that for convenience called the "Insolvency Issue".

With respect to this issue, the Opinion was against the Petitioner upon the ground that "the Petitioner has failed to prove that it was insolvent at any time during the receivership in 1936".

The opinion states that

“We think a corporation is insolvent within the meaning of section 14 (d) (2), *Supra*, if at any time during receivership it is unable to meet its obligations as they mature in the ordinary course of business, with a reasonable use of its credit.

“All of petitioner’s oil and gas property was in the possession and control of trustees appointed by the court in the *Julian v. Schwartz* litigation. The remaining assets were in the possession and control of a receiver appointed in the litigation instituted by *D. R. Morrow* in 1931. The balance sheets of petitioner at the close of the years 1932, 1933, 1934, and 1935 reflect, exclusive of the oil and gas properties, no cash on hand. Other assets on which something might have been realized consisted of supplies in the amount of \$594.09, patents \$1,000, stock issued for services and leases \$219,120.50, and accounts receivable of \$35,507.19.”

Apparently, the decision of insolvency hinged upon Petitioner meeting “its obligations as they mature in the [212] ordinary course of business, with a reasonable use of its credit.” (Emphasis supplied)

The opinion further states:

“The burden was on petitioner to establish its insolvency and any deficiency of proof must operate against it. No attempt was made to show inability to meet maturing debts by a reasonable use of credit. It is true that the

oil and gas properties were in the possession and control of the trustees and for that reason could not have been used by the receiver as collateral for a loan, but he had under his control stock of a book value of about \$220,000. Nothing of record is opposed to the idea that this stock could have been used as security for a loan or sold to pay debts. Neither does it appear that an application was ever made to the court for permission to sell receiver's certificates or otherwise raise funds to meet matured obligations."

Whether or not something might have been realized upon "Other Assets" of the Petitioner depends upon what the asset consists of and whether any value could have been realized as well as the interpretation made of the asset in the opinion.

Patents in the amount of \$1,000.00 were charged off as being worthless by the Petitioner on its books in the year 1936 and the deduction for loss claimed by the Petitioner in the year 1936 was disallowed by the Respondent, was an issue raised in this proceeding, but waived by the Petitioner at the time of hearing of this proceeding because of possible worthlessness in a prior year. [213]

The quoted portion of the Opinion states that the receiver "had under his control stock of a book value of about \$220,000.00." In so stating, the Opinion has inadvertently failed to examine and reflect the stipulated facts per Exhibit No. 51. The stock item referred to is set forth on the Balance Sheet, Exhibit No. 51, under the general heading



“Other Assets” and a sub-heading, reading “Capital Stock Issued for Services and Leases, \$219,120.50.” This was not stock in the control or possession of the receiver or of Petitioner, but was stock in Petitioner’s corporation which had been issued by Petitioner to others for services and property and was an intangible asset of no value whatsoever (being what is commonly called “promotion stock” issued to the promoters of Petitioner) and was simply a bookkeeping debit item offset to the amount of promotion stock reflected in the total capital stock issued by the Petitioner, which capital stock item appeared on the liability side of the Balance Sheet, Exhibit No. 51. The Opinion has inadvertently misconstrued this item. Of course, had Petitioner had corporate stock of a value of \$220,000.00, the situation would have been entirely different, but it did not have any stock of this value or otherwise, this is simply a balancing entry, relating to its promotion stock which had in previous years been “issued” (not to Petitioner, but by Petitioner). [214]

It must be remembered that the undisputed testimony was that, until the funds impounded in the litigation were released, Barnhart Morrow Consolidated was without funds to pay its obligations or conduct its affairs (Transcript, page 20).

The accounts receivable of the Petitioner as set forth in the Findings of Fact in the lump sum of \$35,507.19, and without qualification, would appear to have some value, as so stated, but an examination of the same as detailed in the balance sheet of

the Petitioner, Exhibit 51, and the uncontradicted evidence, reveals an entirely different picture. The accounts receivable on Exhibit 51 are qualified by the statement "Collection and realization on which will exceed one year." This was stipulated to by the Respondent. Considering now each item of said total of \$35,507.19, the evidence shows as follows.

The amount shown receivable from C. C. Julian of \$7,104.61 remained constant from December, 1930 to December 31, 1935. C. C. Julian died a suicide in China in 1934, leaving no estate, and the collection of that account is most doubtful. Certainly nothing could be realized thereon.

The amount shown as due from W. J. Barnhart, former officer of the Petitioner, originated through claims for excessive salary and other items against [215] him by the Petitioner and was settled by an assignment of an interest in the proceeds of production said Barnhart held in an oil well of the East Santa Fe Springs Oil Company. The deferred credit on the Liability side of Petitioner's balance sheet in the amount of \$5,333.25 originated with the assignment from Barnhart, and to that extent is a valuation account of the total amount due from him. To the extent that proceeds of production pertaining to the interest assigned by Barnhart, would produce the total sum of \$21,978.09, profit would be realized in the amount of the deferred credit. But the amount due

from Barnhart remained constant for the years 1933, 1934 and 1935, as shown on Exhibit 51, and accordingly nothing could be realized on it.

Sundry accounts receivable aggregating \$296.31 are insignificant in amount, and the same remained constant for the years 1932, 1933, 1934 and 1935 as shown on Exhibit 51, and nothing could be realized on them.

The amount receivable from the Texas Co. represents, as stated on Exhibit 51, "Gas Revenues Withheld" which were withheld by that company pending the final determination of the litigation of Julian v. Schwartz.

The amount receivable from J. A. Smith is marked on Exhibit 51 "Contra against indebtedness due him" [216] and nothing could therefore be realized thereon. That amount was taken into consideration in the settlement made with him in 1936, Exhibit 45a, wherein the additional sum of \$16,500.10 was paid to him, which amount is not reflected on the Petitioner's books in 1935 since the final determination in the Julian v. Schwartz matter was not finally determined until October, 1936.

Thus it is clear there was no value to these accounts receivable and nothing was available therefrom to meet obligations of the Petitioner, and nothing to form the basis of credit.

The opinion raises the question as to whether "an application was ever made to the court for permission to sell receiver's certificates or otherwise raise funds to meet matured obligations." To

make such an application to the court would have been folly under the known circumstances of Petitioner's financial condition, its entire existence depending upon the final determination in the Julian v. Schwartz matter. If Petitioner had not been successful in its litigation in that matter, its own receivership would have unquestionably developed into one of liquidation in bankruptcy. No one could have been expected to buy Receiver's Certificates with no assets in the receivership estate other than the possibility of winning a lawsuit; likewise, surely it cannot be presumed that a Court would have authorized the sale of Receiver's Certificates simply for the possibility of raising funds to pay liabilities existing at the time of the creation of the receivership. [217]

#### ADDITIONAL FINDINGS NECESSARY AS TO INCOME AND EXPENSES OF PETI- TIONER IN YEARS 1936 AND 1937

Additional findings should be made with respect to Petitioner's income and expenses for the years 1936 and 1937.

Petitioner's income and expenses for the year 1936, set forth in the findings of fact, were apparently taken from Exhibit No. 60, except that the item "oil and gas sales after November 1, less expenses" was apparently inadvertently stated at \$6,436.30, which amount is exactly twice the amount of net operating profit or loss as shown on Exhibit No. 60. The findings of fact, however, do not set forth the income and expenses as respects

each of the oil wells separately as set forth on Exhibits 59 and 60, and such findings are material and necessary in order that the depletion allowance as respects each of the wells separately can be correctly determined. This is particularly so because the Petitioner and the Respondent cannot agree upon what constitutes the gross income and the net income of each of the oil wells separately for the year 1936 and the basis upon which the allowance for depletion must be predicated.

Attached hereto as Appendix A is an affidavit of Geo. F. Meitner, pertaining to a conference with a representative of Respondent, showing the necessity and desirability of a [218] further consideration and hearing to the end that additional findings be made.

The findings of fact further do not set forth the gross income, expenses, and net income of the Petitioner for the year 1937 as respects all of the wells or as to each of the oil wells separately, which gross income, expenses, and net income are reflected in Exhibits Nos. 59 and 61; therefore, it is impossible for the Petitioner and the Respondent to agree as to what constitutes the Petitioner's allowable depletion as respects each of the oil wells separately for the year 1937.

The Opinion states:

'Depletion will accordingly be recomputed on the basis of \$488,903.65 as the gross income from the property, the amount of depletion on the entire property for the year 1936 not to exceed, however, 50% of the net income from



the property. There appears to be no difference of opinion between the parties on the facts necessary to compute the net income from the property.”

Since the findings of fact do not determine what constitutes Petitioner's net income from the property for the year 1936 as respects each of the oil wells separately (which was shown on Exhibits Nos. 59, 60 and 61), and further do not determine what constitutes Petitioner's gross income from the property, expenses, and the income from the property as a whole or as respects each of the oil wells separately for the year 1937, [219] additional findings must be had to enable the parties to jointly act under Rule 50.

While it is true that the parties might each submit computations under Rule 50, we earnestly submit that a true, full and accurate making of such computations can only be had after a finding in accordance with the undisputed proof of Exhibits Nos. 59, 60 and 61, as to the gross income, expenses, and net income for each of the wells for each of the years in question. (It is possible that the Board may have considered that Exhibits Nos. 59, 60 and 61 with respect to such income and expenses are part of the Stipulation of Facts, and hence incorporated in the Opinion. They were received without objection, to show the income and expenses, but were not part of the stipulated facts (Record, Page 76).) [220]

## CONCLUSION

Petitioner believes that the Opinion has failed to give effect to the uncontradicted and stipulated evidence in the record as hereinbefore set forth, and that on a reconsideration being had, the Opinion can and should be corrected. We also petition for a rehearing because, if there be any question that the proof as introduced failed to clarify any of these matters, Petitioner asks for a rehearing to the end that all of such matters can be made clear beyond possibility of doubt. The facts involved are not susceptible of dispute, and the interest of justice, we respectfully submit, requires that all of the facts be before the Board with the utmost clarity.

This is a situation where the evidence is known to exist, the facts are known to Respondent, and, if in the labor of preparing the complicated Stipulation of Facts and the Exhibits a part thereof (in the interest of saving the time of this Board) certain matters have been inadvertently overlooked, we know that this Board in the interest of justice will want that situation remedied. We attach hereto as Appendix B, authorities on that subject.

We believe that if a rehearing is granted, a supplement to the Stipulation of facts can be filed in accordance with the facts appearing in the Affidavit of Geo. F. Meitner, [221] hereto attached, and marked Appendix C.

Petitioner, therefore, moves the Board for a reconsideration of the Opinion and Decision herein,

and in the alternative, for a rehearing upon the grounds and for the reasons herein set forth.

This Petitioner also respectfully moves and requests that the Board make additional findings that the income and expenses of Petitioner as to each of the wells for the years 1936 and 1937 was as appears in Exhibits Nos. 59, 60 and 61.

Respectfully submitted,

HAROLD C. MORTON

B. W. BURKHEAD

Attorneys for Petitioner. [222]

## APPENDIX A

State of California,

County of Los Angeles—ss.

George F. Meitner, being duly sworn, states:

Affiant on September 14, 1942, met with A. M. Swanson, Acting Assistant Technical Advisor in the Los Angeles Office of Respondent, to whom this matter has been referred in the operation of Respondent's office, in an endeavor to work out a computation of matters determined in the decision herein (which would have to be done irrespective of rehearing or other review), so that an order for decision can be jointly submitted under Rule 50. As a result of said conference, affiant is advised by said Swanson that Respondent, as to the years 1936 and 1937, starts with the net income as determined by Respondent in his deficiency letter which led to this proceeding. This ignores the findings of the Board insofar as the same have been made with respect to the year 1936, and likewise ignores the undisputed

proof in Exhibits Nos. 59, 60 and 61, wherein Petitioner has established without contradiction the gross and net incomes of each well for each of said years. Under such circumstances, it will be impossible to submit a joint order for decision.

On Exhibits Nos. 59, 60 and 61, Petitioner established the gross and net income for each well for the years 1936 and [223] 1937 respectively. The findings herein do not determine Petitioner's income for each well for the year 1936, and as to 1937 the findings make no reference to the income and expenses for that year.

Affiant believes that it will be necessary that additional findings be made covering these matters in accordance with Exhibits Nos. 59, 60 and 61. (It is possible that the Board may have inadvertently assumed that Exhibits Nos. 59, 60 and 61 were a part of the stipulated facts, and hence were incorporated by reference in the findings of fact.)

GEO. F. MEITNER

Subscribed and sworn to before me this 15th day of September, 1942.

[Seal]

ELSIE H. MACDONELL

Notary Public in and for said County and State.

[224]

APPENDIX B  
AUTHORITIES

In *Underwood vs. Commissioner of Internal Revenue*, 56 Fed. (2d) 67, commencing at Page 72 is the following:

“\*\*\* It is settled that the taxpayer has the burden of proof by a number of decisions of the Supreme Court. \* \* \* But we do not think that this rule so restricts the powers of the Board as to require it to countenance an obvious injustice. ‘The Board of Tax Appeals is not a court. It is an executive or administrative board.’ *Old Colony Trust Co. v. Commissioner*, 279 U. S. 716, 725, 49 S. Ct. 499, 502, 73 L. Ed. 918.

“The Board had ample power under the statute to require the production of additional evidence when it became clear that it could not do injustice to the taxpayer by reason of the deficiencies in the record before it. It was unquestionably incumbent upon the taxpayer to offer the testimony in the first instance, and cases arise where the moving party must suffer the consequences of his own neglect. Here, however, the Board’s own opinion showed that the Commissioner’s action was wrong in a material respect. The information to correct the mistake was readily obtainable from the same source as that from which the gross receipts of the taxpayer were ascertained. Under these circumstances, the Board



should have deferred its decision until testimony showing the amount of the deductions to which the taxpayer was entitled was introduced, and then have redetermined the deficiency. The decision of the Board will therefore be reversed and the case remanded in order that the course indicated may be followed. This action, we think, is authorized by the powers vested in this court by the Revenue Act of 1926, Sec. 1003, 44 Stat. 110, 26 U. S. C. 1226 (26 USCA Sec. 1226), [225] where it is provided that the Circuit Court of Appeals shall have power to modify or reverse a decision of the Board, if not in accordance with the law, with or without remanding the case for a rehearing, as justice may require. In a number of instances, Circuit Courts of Appeals have remanded cases for rehearing when it seemed necessary in order to do justice to the parties. It does not appear in these cases that new evidence was available; but in the instant case the evidence is known to exist and it would be an abuse of discretion to decline to receive it. See *Cohan v. Commissioner* (C.C.A.) 39 F. (2d) 540, 543; *Citrus Soap Co. v. Lucas* (C.C.A.) 42 F. (2d) 372, 373; *Isbell Porter v. Commissioner* (C.C.A.) 40 F. (2d) 432; *Independent Ice & Cold Storage Co. v. Commissioner* (C.C.A.) 50 F. (2d) 31; *Russell v. Commissioner* (C.C.A.) 45 F. (2d) 100. In addition, there is the well-established rule that

an appellate court has the power, without determining and disposing of a case, to remand it to the lower court for further proceedings if the case has been tried on a wrong theory, or the record is not in condition for the appellate court to decide the question presented with justice to all parties concerned. \* \* \*

(Emphasis supplied.)

This case was followed in *Eau Claire Book Co. vs. Commissioner*, 65 Fed. (2d) 125, where at Page 126 it is said:

“Likewise, we are satisfied that it would be in the interest of justice, and fairer to both parties, if the cause were remanded with opportunity given to them to supply, if they wish (*Underwood v. Commissioner of Internal Revenue* (C.C.A.) 56 F. (2d) 67, further evidence as to the value of the property and the services rendered for the giving of the notes which were canceled when the bonds were delivered. Likewise, the date of the sale of [226] the bonds by the taxpayer to its stockholders might well be established with greater certainty.

“The order of the Board of Tax Appeals is reversed, with directions to proceed as indicated in this opinion.” [227]

## APPENDIX C

## AFFIDAVIT OF GEO. G. MEITNER

State of California,

County of Los Angeles—ss.

Geo. F. Meitner, being duly sworn, states: That he is the Geo. F. Meitner who testified at the hearing of this matter; that Exhibit No. 57 herein correctly sets forth the cost to Petitioner of Well No. 16, and all the items in said Exhibit contained are in accordance with vouchers, checks and records in the possession of Petitioners; the depreciation referred to in Exhibit No. 57 is depreciation allowed by the Commissioner (Respondent) in years previous to 1936 and depreciation for the years 1936 and 1937 as allowed by Respondent. Petitioner has never expensed intangible drilling costs but same have been capitalized.

Respondent in considering Petitioner's income tax return for the year 1937 redetermined the cost of Well No. 16 for the purpose of calculating the allowable depreciation on the well equipment, which was so redetermined because of the collapse of tubing and casing in Well No. 16 in March of 1937, which resulted in the retiring of the cost of this tubing and casing so collapsed as well as retiring the depreciation applicable to the casing and tubing which had collapsed; that redetermined cost, as well as the depreciation [228] pertaining to the same, was shown on Exhibit No. 57. Petitioner and Respondent were in accord on these matters prior to the petition to this Board.

In conferences leading up to the making of the Stipulation of Facts herein Respondent did not question the amount of the loss on Well No. 16, except as the depletion issue might be determined, but questioned the loss because the well was quit-claimed to J. A. Smith as stated by Mr. Tonjes at Page 10 of the Record in this proceeding.

Petitioner had no credit during the period of its receivership; that the item on Petitioner's Balance Sheet, Exhibit No. 51, "Capital Stock Issued For Services and Leases \$219,120.50", referred to stock issued by Petitioner to others for services and leases, and was simply an intangible item of no value, being what is commonly called "promotion stock".

GEO. F. MEITNER

Subscribed and Sworn to before me this 15th day of September, 1942.

[Seal] ELSIE H. MACDONELL

Notary Public in and for the County of Los Angeles, State of California.

[Endorsed]: U.S.B.T.A. Filed Sep. 17, 1942.

[229]

[Title of Tax Court and Cause.]

### ORDER

Upon consideration of the motion filed herein on September 17, 1942, by petitioner, for reconsideration relates to a rehearing and to reconsideration herein on August 20, 1942, or a rehearing, it is

Ordered: That to the extent that the said motion relates to a rehearing and to reconsideration of the issues on loss deduction for well No. 16 and insolvency, it be and is hereby denied.

For cause appearing of record, it is further

Ordered: That

(a) The figures \$3,218.15, \$151,599.81, \$116,115.67, \$142,989.99, and \$60,908.31 be and they are hereby inserted in lieu of the figures \$6,436.30, \$154,817.96, \$119,333.82, \$122,371.37, and \$60,568.15, respectively, appearing on pages 7, 8, 14 and 17 of the printed opinion entered herein.

(b) The following be included in the findings of fact:

“The gross income, operating expenses and net income of petitioner in 1936 and 1937 from the wells shown were as follows: [230]



Well No.	Gross Income		Operating Expenses		Net Income	
	1936	1937	1936	1937	1936	1937
1	\$116,854.21	\$ 27,826.40	\$ 43,683.20	\$ 7,393.66	\$ 73,171.01	\$20,432.74
2	127,981.99	16,297.57	51,184.71	8,004.45	76,797.28	8,293.12
3	105,567.29	12,837.22	49,689.07	8,087.04	55,878.22	4,750.18
11	17,225.80	462.19	43,821.86	4,477.39	26,596.06*	4,015.20*
16	66,329.95	7,464.73	26,292.37	10,723.51	40,037.58	3,258.78*
17	70,391.51	7,663.57	22,984.07	8,268.25	47,407.44	604.63*
Kern Co. Lease		7,673.70		27,920.03		20,246.33*

---

\* Loss. "

It is further

Ordered: That allowances for depletion in the taxable years be recomputed under Rule 50 in accordance with the findings of fact of this Court, as amended and supplemented by this order.

[Seal] (S) R. L. DISNEY

Judge.

Dated: Washington, D. C., December 4, 1942.

[231]

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[Title of Tax Court and Cause.]

PETITIONER'S COMPUTATION FOR  
ENTRY OF DECISION

The attached proposed computation is submitted on behalf of the petitioner, to The Tax Court of the United States (formerly the United States Board of Tax Appeals), in compliance with its opinion determining the issues in this proceeding.

This computation is submitted in accordance with the findings of fact and opinion of the Court, without prejudice to the petitioner's right to contest the correctness of the decision entered herein by the Court, pursuant to the statutes in such cases made and provided.

HAROLD C. MORTON

Attorney for Petitioner

GEO. F. MEITNER

Certified Public Accountant  
for Petitioner

Of Counsel:

B. W. BURKHEAD, ESQ.,

Los Angeles, Calif.

March 24, 1943.

Copy served 3/29/43. [232]

## RECOMPUTATION STATEMENT

In Re: Barnhart-Morrow Consolidated, 1020 Subway Terminal Building, 417 South Hill Street, Los Angeles, California.

Docket No. 105 859

### Income Tax Liability

Year	Tax Liability	Tax Assessed	Deficiency
1936	\$ 4,282.58	none	\$ 4,282.58
1937	15,816.89	none	15,816.89

A recomputation of the income tax liabilities of the Petitioner for the years 1936 and 1937 has been made, as hereinafter set forth, pursuant to the findings of fact of the United States Board of Tax Appeals (now The Tax Court of the United States) and its opinion promulgated August 20, 1942, which was amended and supplemented by an order dated December 4, 1942.

The decision as amended held as follows:

1. That the debt of \$16,500.00 was ascertained to be worthless and charged off in 1936, is an allowable deduction.

2. That the amount of salary of \$7,000.00 cancelled in 1936 does not constitute taxable income to the petitioner in that year.

3. That the petitioner has failed to prove that it was insolvent at any time during that period within the meaning of Section 14 (d) (2) of the Revenue Act of 1936.

4. That the amount paid to petitioner in 1936, plus the amount of income which had been expended for operating expenses, constitutes gross income received from the property by petitioner in 1936 for depletion purposes.

5. That petitioner may not deduct any amount as a loss, on account of failure to prove the cost of the property on abandonment of oil well number 16.

The computation of net taxable income and depletion allowable for the year 1936 submitted in Exhibit A herewith, are in accordance with the facts found by the Court as set forth in the printed opinion promulgated August 20, 1942, and as such facts were amended and supplemented by paragraph marked (a) of the Order dated December 4, 1942 and the opinion of the Court (page 16 of the printed opinion). Accordingly to the income and [233] expenses of petitioner for the year 1936, as found by the Court and as set forth on pages 7 and 8 of the printed opinion and as amended and supplemented by paragraph (a) of the Order dated December 4, 1942, there has been added to gross income in 1936 the sum of \$223,352.83, representing expenses incurred by the trustees in the operation of the properties, all of which was chargeable to and charged to petitioner and held to be gross income in 1936 from the property. A like sum has been added to the operating expenses for the year

1936 as set forth in paragraph (b) of the Order dated December 4, 1942.

To the extent that paragraph (b) of the Order dated December 4, 1942, determining the gross income for the year 1936 to be an aggregate for all wells of \$504,350.75, is contradictory to the determination of gross income for the year 1936 as determined pursuant to the facts and opinion of the Court as set forth in the preceding paragraph of said Order dated December 4, 1942, in that the gross income of \$504,350.75 so set forth, includes the cash distributed to the petitioner from impounded funds in the year 1937 and subsequently totaling \$122,560.83 less the sum of \$2,073.50, representing discounts received and income from sale of junk, or a net amount of \$120,487.33, the determination so made has been ignored in the computation made for the year 1936.

In conformity with the facts and the opinion, and accordingly contrary to paragraph (b) of the Order dated December 4, 1942, because of the difference in gross income for the year 1936 as set forth above, the aggregate gross income of all wells for the year 1937 totaling \$80,225.38 set forth in said order dated December 4, 1942, has been increased by the amount of \$122,371.37 received by the petitioner in 1937 and so reflective in Exhibit B submitted herewith.



## Taxable Year Ended December 31, 1936

## Adjustments to Net Income

Net Income disclosed by the Statutory Notice of deficiency dated September 18, 1940.....	\$103,901.78
As corrected in accordance with the Tax Court's Finding of Facts and Opinion .....	35,712.14
Difference (decrease) .....	<u>\$ 68,189.64</u>

## Increases

(a) .....	none
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## Decreases

(b) Depletion .....	\$32,871.01
(c) Loss—payment to J. A. Smith.....	16,500.10
(d) Accrued Salary .....	7,000.00
(e) Receivership Expenses .....	\$17,574.68
Less—Amount allowed by Respondent .....	<u>5,666.15</u>

Additional allowable .....	<u>11,908.53</u>
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Net decrease .....	<u>\$ 68,189.64</u>
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[234]

## Income Tax

(a) Income from Oil Wells	1936	1937
Net Income before depletion (Exhibit A and B).....	\$146,208.14	\$127,722.42
Reflected in the statutory notice as reported .....	145,995.31	129,790.66
Difference: Increase (decrease) .....	<u>\$ 212.83</u>	<u>\$ ( 2,068.24)</u>

## Represented by:

Increase (decrease) shown by

Respondent .....	\$122,773.66	(\$124,439.61)
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Apparently being

Distributions made in 1937 in

Julian vs. Schwartz .....	122,371.37	(122,371.37)
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Distributions subsequent to 1937

in Julian vs. Schwartz.....	189.46	
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Total .....	<u>122,560.83</u>	<u>(122,371.37)</u>
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Difference of Respondent Un-

accountable .....	<u>\$ 212.83</u>	<u>(\$ 2,068.24)</u>
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(b) Depletion	1936	1937
Depletion allowable (Exhibit A and B) .....	0	
Allowed in statutory notice.....	\$ 80,453.53	\$ 56,672.54
	47,622.52	56,672.54
	<hr/>	<hr/>
(Additional) excessive .....	(\$ 32,781.01)	\$ .....
	<hr/>	<hr/>

[235]

Computation of Tax  
Year 1936

No excess-profits tax due since the first capital stock tax year ended June 30, 1937.

Normal Tax

Net income as corrected .....	\$ 35,712.14
Normal tax net income.....	35,712.14

8% on \$ 2,000.00 .....	\$ 160.00
11% on 13,000.00 .....	1,430.00
13% on 20,712.14 .....	2,692.58

Normal Tax .....	4,282.58
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Surtax on Undistributed Profits

Net Income as corrected.....	\$35,712.04
Less: Normal Tax .....	4,282.58

Adjusted net income .....	31,429.46
Dividends paid .....	none

Undistributed net income.....	31,429.46
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7% on \$ 5,000.00 .....	350.00
12% on 3,142.95 .....	377.15
17% on 6,283.90 .....	1,068.26
22% on 6,283.90 .....	1,382.46
27% on 10,718.71 .....	2,894.05

Surtax .....	6,071.92
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Total income tax .....	10,354.50
Income tax assessed .....	none

Tentative Tax Liability .....	\$ 10,354.50
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Pursuant to the provisions of Section 26 (c) of the Revenue Act of 1936 as amended by the Revenue Act of 1942, Sections 501 (a) (2) and (3), Petitioner does not believe it to be liable for Surtax on Undistributed Profits for the year.

Petitioner contends that it was prohibited from declaring dividends in the year 1936 by the prohibition contained in Section 346 (2) Civil Code of the State of California. [236]

Section 346 of the Civil Code of the State of California reads as follows:

“Sec. 346. Cash or Property Dividends. A corporation may declare dividends payable in cash or in property only as follows:

(1) Out of earned surplus; or

(2) Despite the fact that the net assets of the corporation amount to less than the stated capital, out of net profits earned during the preceding accounting period which shall not be less than six months nor more than one year in duration; or

(3) Out of paid-in surplus or surplus arising from reduction of stated capital subject to the provisions of section 348b, Civil Code, only upon shares entitled to preferential dividends; provided that notice shall be given to the shareholders receiving such dividends of the source thereof prior to or concurrently with the payment thereof.

“Impaired Assets. If the value of the net assets amounts to less, through depreciation, depletion, losses, or otherwise, than the aggregate amount of stated capital attributed to shares having liquidation preferences, the corporation shall not declare dividends out of net profits pursuant to subdivision

(2) of this section, except upon such shares, until the value of the net assets has been restored to such aggregate amount of the stated capital attributed to outstanding shares having liquidation preferences.

“Dividends. No dividends shall be declared when there is reasonable ground for believing that thereupon the corporation’s debts and liabilities would exceed its assets or that it would be unable to meet its debts and liabilities as they mature.

“No dividends shall be declared out of the mere appreciation in the value of its assets not yet realized, nor shall any dividends be declared from earned surplus representing profits derived from an exchange of assets unless and until such profits have been realized or unless the assets received are currently realizable in cash.

“Wasting Asset Corporation. A wasting asset corporation, that is a corporation engaged solely or substantially in the exploitation of mines, oil wells, gas wells, patents or other wasting assets, or organized solely or substantially to liquidate specific assets, may distribute the net income derived from the exploitation of such wasting assets or the net proceeds derived from such liquidation without making any deduction or allowance for the depletion of such assets incidental to the lapse of time, consumption, liquidation or exploitation; subject, however, to adequate provision for meeting debts and liabilities and the [237] liquidation preferences of outstanding shares and to notice to shareholders that no deduction or allowance has been made for such depletion. Added by Stats. 1931, p. 1803; Amended by Stats. 1933, p. 1384.)”

Since the petitioner's accounting period is on the calendar year basis and since its preceding accounting period ending on December 31, 1935 showed a loss of \$6,063.64, and further, since petitioner's "Surplus" on December 31, 1935 was a deficit of \$172,161.65 (pages 6 and 7 of the written opinion promulgated August 20, 1942) that no liability for Surtax on Undistributed Profits for the year 1936 exists.

Accordingly petitioner sets forth herein its liability for income taxes for the year 1936 to be the amount of its normal income tax amounting to \$4,282.58 as submitted herein.

#### Taxable Year Ended December 31, 1937

##### Adjustments to Net Income

Net Income disclosed by the statutory notice of Deficiency dated September 18, 1940.....	\$ 61,795.85
As corrected in accordance with the Tax Court's Finding of Facts and Opinion as stated herein.....	61,795.85

Difference (Increase) or Decrease.....	<u>none</u>
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##### Excess Profits Tax

Net Income for excess profits computation .....	\$61,795.85
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Value of capital stock declared in capital stock tax return filed for the year ended June 30, 1937 .....	<u>\$800,000.00</u>
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10% of Declared Value.....	80,000.00
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Dividends Received Credit	
85% of \$14,026.50 .....	<u>11,922.52</u>

Total.....	<u>91,922.52</u>
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Balance subject to excess profits tax.....	<u>none</u>
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Excess Profits Tax .....	<u>none</u>
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Taxable Year Ended December 31, 1937

Adjustments to Net Income

Normal Tax

Net Income for Income Tax Computation .....	\$61,795.85
Dividends Received Credit	
85% of \$14,026.50 .....	11,922.52
Balance subject to normal tax.....	<u>49,873.33</u>

8% on \$ 2,000.00.....	\$ 160.00
11% on 13,000.00.....	1,430.00
13% on 25,000.00.....	3,250.00
15% on 9,873.33.....	<u>1,481.00</u>

Total Normal Tax .....\$ 6,321.00

Undistributed Profits Surtax Computation

Net Income for income tax computation .....	\$61,795.85	
Less—Normal tax as above.....	6,321.00	
1. Adjusted net income.....	<u>55,474.85</u>	
Less—Credit for Dividends Paid.....	<u>6,949.77</u>	
2. Undistributed net income .....	<u>48,525.08</u>	
3. Portion taxable at 7%: \$5,000.00 or 10% of \$55,- 474.85 whichever is great- er .....	\$ 5,547.49	388.32
4. Portion taxable at 12%: 10% of Item 1 (But not more than Item 2 minus Item 3) .....	5,547.49	665.70
5. Portion taxable at 17%: 20% of Item 1 (but not more than Item 2 minus Items 3 and 4).....	11,094.97	1,886.14
6. Portion taxable at 22%: 20% of Item 1 (but not more than Item 2 minus Items 3 to 5).....	11,094.97	2,440.89
7. Portion taxable at 27%: Item 2 minus items 3 to 6)	15,240.16	<u>4,114.84</u>
Total Undistributed Profits Tax.....		9,495.89
Total Normal Tax and Surtax.....		<u>\$ 15,816.89</u>



## Springs Lease

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	Well No. 11	Well No. 16	Well No. 17
B	\$(13 579 12)	\$22 758 60	\$ 25 834 10



EXHIBIT A  
BARNHART-MORROW CONSOLIDATED

YEAR 1936

		Santa Fe Springs Lease					
	Total	Well No. 1	Well No. 2	Well No. 3	Well No. 11	Well No. 16	Well No. 17
GROSS INCOME							
Impounded Funds							
Distributions in 1936.....	\$142,989.99	\$ 38,039.82	\$ 40,323.67	\$ 29,612.53	\$(13,579.12)	\$22,758.60	\$ 25,834.49
Expenses of Operations .....	223,352.83	41,732.64	49,309.34	47,826.88	41,885.12	21,606.71	20,992.14
Total Impounded Funds.....	366,342.82	79,772.46	89,633.01	77,439.41	28,306.00	44,365.31	46,826.63
Oil and Gas Sales in 1936.....	17,520.60	4,819.82	4,129.49	3,089.21	916.91	2,800.67	1,764.50
Total Gross Income.....	383,863.42	84,592.28	93,762.50	80,528.62	29,222.91	47,165.98	48,591.13
EXPENSES							
Impounded Funds .....	223,352.83	41,732.64	49,309.34	47,826.88	41,885.12	21,606.71	20,992.14
Oil and Gas Sales .....	14,302.45	1,950.56	1,875.37	1,862.19	1,936.74	4,685.66	1,991.93
Total Expenses .....	237,655.28	43,683.20	51,184.71	49,689.07	43,821.86	26,292.37	22,984.07
Net Income Before Depletion.....	146,208.14	40,909.08	42,577.79	30,839.55	(14,598.95)	20,873.61	25,607.06
DEPLETION							
27½% of Gross Income limited to 50% of Net Income (See below).....	80,403.53	20,454.54	21,288.89	15,419.77	.....	10,436.80	12,803.53
Net Income After Depletion.....	65,804.61	\$20,454.54	\$ 21,288.90	\$ 15,419.78	\$(14,598.95)	\$10,436.81	\$ 12,803.53
OTHER INCOME							
Rental on Drilling Equipment.....	5,000.00						
Claim for interest on Note indebted- ness relinquished in 1936.....	391.67						
Total .....	71,196.28						
OTHER INCOME DEDUCTIONS							
Interest Paid .....	1,409.36						
Loss—Payments to J. A. Smith.....	16,500.10						
Receivership Expenses .....	17,574.68						
Total Income Deductions.....	35,484.14						
Net Taxable Income .....	\$ 35,712.14						
DEPLETION							
27½% of Gross Income .....	\$105,562.42	\$ 23,262.87	\$ 25,784.68	\$ 22,145.37	\$ 8,036.30	\$ 12,970.64	\$ 13,362.56
50% of Net Income before allowance for Depletion .....	80,403.53	20,454.54	21,388.89	15,419.77	.....	10,436.80	12,803.53
Depletion allowable .....	80,403.53	20,454.54	21,288.89	15,419.77	.....	10,436.80	12,803.53

Note: Figures in parentheses are red (loss) figures.

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EXHIBIT B  
BARNHART-MORROW CONSOLIDATED

	Total	Santa Fe Springs Lease						Kern County Land Co. Lease
		Well No. 1	Well No. 2	Well No. 3	Well No. 11	Well No. 16	Well No. 17	
GROSS INCOME								
Impounded Funds								
Distributions released in the year 1937 by the Court of Julian v. Schwartz.....	\$122,371.37	\$ 32,554.62	\$ 34,509.14	\$ 25,342.52	(\$11,621.06)	\$19,476.90	\$ 22,109.25	\$
Oil and Gas Sales in 1937.....	80,225.38	27,826.40	16,297.57	12,837.22	462.19	7,464.73	7,663.57	7,673.70
Total Gross Income .....	202,596.75	60,381.02	50,806.71	38,179.74	( 11,158.87)	26,941.63	29,772.82	7,673.70
EXPENSES								
Oil and Gas Sales .....	74,874.33	7,393.66	8,004.45	8,087.04	4,477.39	10,723.51	8,268.25	27,920.03
NET INCOME BEFORE DEPLETION .....	127,722.42	52,987.36	42,802.26	30,092.70	( 15,636.26)	16,218.12	21,504.57	(20,246.33)
DEPLETION								
27½% of Gross Income limited to 50% of net income (see below).....	56,672.54	16,604.78	13,971.85	10,499.43	.....	7,408.95	8,187.53	.....
NET INCOME AFTER DEPLETION .....	71,049.88	\$ 36,382.58	\$ 28,830.41	\$ 19,593.27	(\$15,636.26)	\$ 8,809.17	\$ 13,317.04	(\$20,246.33)
OTHER INCOME								
Distributions received on Oil Participating Agreements in Julian Wells Nos. 1, 2 and 3, being dividends received for the year 1937.....	14,026.50							
Cash Discounts Received .....	505.69							
Income from sale of Miscellaneous Casing.....	121.42							
Income for drilling oil well for others.....	3,000.00							
Total .....	88,703.49							
OTHER INCOME DEDUCTIONS								
Loss sustained on Davies Well No. 1 abandoned on April 27, 1937 .....	23,818.13							
Interest Paid .....	3,089.51							
Total Income Deductions .....	26,907.64							
NET TAXABLE INCOME .....	\$ 61,795.85							
DEPLETION								
27½% of Gross Income .....	\$ 58,782.81	\$ 16,604.78	\$ 13,971.85	\$ 10,499.43	.....	\$ 7,408.95	\$ 8,187.53	\$ 2,110.27
50% of Net Income before allowance for depletion .....	81,802.50	26,493.68	21,401.13	15,046.35	.....	8,109.06	10,752.28	.....
Depletion Allowable .....	56,672.54	16,604.78	13,971.85	10,499.43	.....	7,408.95	8,187.53	.....

Note: Figures in parentheses are red (loss) figures.

[Endorsed]: T.C.U.S. Filed Mar. 26, 1943. [241]



[Title of Tax Court and Cause.]

## REPORTER'S MINUTES

Hearing in Court Room No. 1, Internal Revenue Building, Washington, D. C., on the 5th day of May, 1943, at 9:45 O'clock A. M.

The above-entitled proceeding came on for hearing on this, the 5th day of May, 1943, before the Honorable R. L. Disney, a Judge of the Tax Court of the United States, at Washington, D. C., pursuant to notice of hearing heretofore given, whereupon the following proceedings were had, and testimony heard, to wit:

### Appearances:

G. F. MEITNER, ESQ.,

Suite 711, 405 South Hill St., Los Angeles, California, Appearing on Behalf of the Petitioner;

ROBERT C. WHITLEY, ESQ.,

(Honorable J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue), Appearing on Behalf of the Commissioner of Internal Revenue. [243]

## PROCEEDINGS

The Clerk: Docket No. 105859, Barnhart-Morrow Consolidated.

Mr. Whitley: Your Honor, please, this is a case which is set for hearing at this time on computation submitted by the parties under Rule 50.

Both parties have submitted computations and there is considerable difference in the deficiencies computed by each party.

In addition to the computation of deficiencies giving effect to depletion, which was an issue in the trial of the case, the petitioner has now raised the question of applicability of the 1942 Act, Section 501 (a) thereof, which deals with a deficit claimed with respect to the taxable year involved.

It is Respondent's position that the provisions of the 1942 Act are not applicable in this case, and that the estate tax, referring to the condition or the prohibition of paying dividends is not applicable to the facts in this case.

Before the conclusion of this hearing, I want to offer a memorandum in support of Respondent's contention, which I believe will set forth clearly Respondent's position on both applicability of the 1942 Act and with respect to depletion. [244]

Judge Disney: I am wondering about the date. It seems rather late to suggest at this hearing the applicability of a section not before suggested.

I wonder about that. Does this bring up something that would probably be called a new trial on it? We are not supposed to re-try this matter on a hearing upon recomputation.

Mr. Meitner: Your Honor, I would like to know what the position of the Court is with respect to the provisions made by the 1942 Act as to their retroactivity on the 1936 Act, which involved this particular matter, and therefore the issue was raised in a recomputation hearing.



In other words, the late passage of the 1942 Act didn't give us much of an opportunity to file the application here until last Monday.

Judge Disney: The Act was passed last fall. It is not a late passage.

Mr. Meitner: Petitioner being in contact with Respondent, represented in Los Angeles, that they would come together on a computation and were able to get together, and in view of the fact mentioned—that they were going to get together, respondent with petitioner's counsel, which was never done; consequently there was not very much to do but for petitioner to raise the issue at this particular time. [245]

Judge Disney: It is in my mind whether this could be raised by a motion for reconsideration. Those 1942 sections—there are several of them, as you know—two or three anyhow that have been considered; and the question in my mind now is the propriety of raising this question on a recomputation proceeding.

Is this going to call for any further facts or further proof or merely a review upon the law?

Mr. Meitner: I think further proof will be necessary and further facts as it involves depletion.

Judge Disney: You mean you have further proof and further facts to offer here today on this question?

Mr. Meitner: No, not today, your Honor because of the situation which is involved. In other words, this is a deficit corporation at this particular time.

Judge Disney: And you are going to have to prove that?

Mr. Meitner: We are going to have to prove that fact—that it is a deficit corporation. Its surplus is in the red and they could not pay the dividends out of Section 46 of the Civil Code of California.

Judge Disney: Let me ask you—I don't want to divert an attorney's mind from his train of thought—is your deficit in the previous years—a clear deficit [246] at the beginning of the year?

Mr. Meitner: At the beginning of the year, yes; and that deficit continues right straight through.

Exhibit No. 51, which was submitted at the trial, gives the balance sheet for 1935 and shows a deficit of some one hundred and seventy-odd thousand dollars, I believe.

The situation involved here involves computation of depletion. Depletion is only computed on a percentage basis. The question is, whether gross depletion would involve the deficit figure as shown. We don't believe it will.

Judge Disney: We don't like to try these cases upon recomputation. We never would get through if we did that. A recomputation is supposed to serve the purpose, as I understand it, and I think it is quite obvious, of stipulating what may be called "the figures", by agreement, if possible, between the parties, and if not possible, finally suggesting the matter to the Court—relieving the Court thereby of the matter of working out the figures of the case.

In other words, trying the points and the parties getting together as near as possible on the figures.

Now, it is obvious that there is a real reason for not bringing in new facts, new proof, new evidence, upon a re- [247] computation. I don't think that that should be considered upon this recomputation at all; that I should hear you on new evidence. But I am not saying that perhaps you might be allowed to file a motion for reconsideration, to set up such new facts if you show proper grounds for doing so.

I don't think we can have a motion upon your present pleading now.

Mr. Meitner: Well, your Honor, the only recomputation here was to bring it to the Court's attention, and enough to argue on the facts with respect to that particular end of it, and to show the applicability of that section.

Judge Disney: How can I apply it unless we have some facts to show you are a deficit corporation. Didn't you say a moment ago you were going to show these facts.

Mr. Meitner: Yes, we have to file or have filed our Exhibit No. 51, which shows this corporation to be a deficit corporation.

Judge Disney: You mean already; you have the evidence already?

Mr. Meitner: In the records, your Honor, yes.

Judge Disney: Do I gather you don't mean to offer new evidence on this subject?

Mr. Meitner: Not entirely new, unless it is required [248] by the Court.

Judge Disney: It is up to you now what evidence you offer. I am not telling you what evidence to offer. You make your case, and the Government makes its case.

Mr. Meitner: Exhibit No. 51, part 2, which shows as of 1935 \$172,161.65, which is a deficit.

Judge Disney: Perhaps I misunderstood you.

Mr. Meitner: The facts are not exactly in the record now—I am not proposing any new evidence unless the Court deems it proper, if new evidence is necessary to sustain that figure. In other words, not now.

Judge Disney: I am not telling you what evidence to make your case or not make your case. If you think you have sufficient upon which to base your view of a recomputation upon this question of the 1942 Act, why of course it would appear your recomputation is properly to be considered. All I was suggesting was that I understood that you needed some further evidence in the record and that I did not propose to receive new evidence in the record upon a recomputation; but it might possibly be you should be allowed to file a motion for reconsideration to bring in new evidence.

Now, that does not appear to be the situation; you are depending on now the evidence in the record.

Mr. Meitner: Right, since Exhibit No. 51 has al-[249] ready been submitted as part of our stipulation of facts, showing petitioner to have a deficit of \$172,161.65 as of December 31, 1935, which is the end of its preceding accounting period, and since

Section 346 of the Civil Code of California prohibits the paying out of dividends where a deficit exists, and since Section 501 (a) 2 and 3 of the 1942 Act gives relief to the petitioner, which section amends Section 26(c) of the 1926 Act, giving relief to the petitioner where such deficit does exist and the law prohibits the paying out of dividends where such deficit exists——

Judge Disney: (Interposing) Let's understand each other. As I get this now, you are simply asking that I take into consideration, in arriving at the proper decision here as between you and your opponent, that I take into consideration the facts already in the record and take that 1942 Act into consideration?

Mr. Meitner: That is right, your Honor.

Judge Disney: Is there any reason why that should not be done (addressing Mr. Whitley, counsel for Commissioner)?

Mr. Whitley: As your Honor has pointed out, I considered it not a matter before the Court in the first instance. But if petitioner's counsel, as he now points out, is relying on evidence in the record, then the com- [250] putation may be given consideration; that the Court may be given the computations under those facts and may properly consider the effect of the 1942 Act, I think.

Judge Disney: I think it is rather apparent that certain courts expect us to take those Acts into consideration and I think that is in general the attitude of the Government. I have had more than one case submitted to me, and I think we probably would



be taking a chance on reversal if we did not take those Acts into consideration, upon the facts in the record. I believe I have agreed between the Government and the parties to do that thing. There is no use in having it go up.

We will take into consideration the 1942 Act upon the facts now in the record, but not receive additional evidence on recomputation.

Mr. Whitley: On that motion your Honor, of the problem, I now offer a memorandum in support of the Respondent's computation under Rule 50, which will deal somewhat with the question of applicability of the 1942 Act.

(At this point, the document referred to was handed to the Clerk by Counsel.)

Judge Disney: Now, does counsel for petitioner have anything further to say. Do you wish time in which to submit a memorandum or do you have one? [251]

Mr. Meitner: I don't have a memorandum prepared, your Honor, at this particular time—not knowing what the situation would be about raising this particular issue, the consideration of the 1942 Act.

Judge Disney: I think I should consider it, and as long as you do not, if you *want will* give you a few days to file a memorandum. I will give you that opportunity if you wish it.

Mr. Meitner: All right, your Honor. I will be glad to do that.

Judge Disney: Unless you have stated the mat-

ter—all you wish in your motion. I haven't looked at your motion yet. I assume this is a matter of some complexity. I want to study it anyway.

Do you want to file a memorandum?

Mr. Meitner: As to the applicability of the 1942 Act?

Judge Disney: And its application to the facts you submitted here. I would be glad to have you do so.

Mr. Meitner: I have quoted the Section of the Revenue Act on Section 346 of the Civil Code of California, your Honor, and I think that controls here.

Judge Disney: If you don't want to file a memorandum, that is up to you.

Mr. Meitner: I don't think any additional memorandum [252] is necessary under the circumstances, as the facts are in evidence now.

Judge Disney: Very well. I will take the matter under consideration, and the memorandum will be received on the part of the Respondent; and I will decide it within the next few days probably.

Mr. Meitner: The only other issue, your Honor, that seems to be at variance—I don't know whether it is in proper order to take it up now for discussion—the variance in the determination of what is the gross income of the petitioner as computed by Respondent and that as computed by petitioner.

Judge Disney: Of course I will hear you on any discussion as to differences. I want all the light I can get.

Mr. Meitner: The question brought up is that in Section (b) of the Supplemental Order issued under date of December 4, determining what constitutes petitioner's gross income for the year 1936.

Judge Disney: Yes.

Mr. Meitner: That includes the sum of \$122,371.37. That was not received by the petitioner until the year 1937. That particular money could not be received by petitioner until or under the order of the Court in the case of Julian v. Schwartz.

[253]

That was not determined until August 13, 1937, in accordance with the agreement that was entered into by the Commissioner of Internal Revenue and petitioner, and the other parties mentioned in the matter, which I believe was Exhibit No. 42 included in the Stipulation of Facts. That agreement provided that the recipient of the funds distributed by the trustees would be reported in the years received by them, and the \$122,371.37 which was received by Barnhart-Morrow Consolidated was received after the agreement ratified by the Commissioner.

In the event that agreement had not been taken into consideration, it is possible that petitioner wouldn't have received any of that money, because it was not subject to his demand at the time and he was subject to the control of the Court in the matter of Julian v. Schwartz and any income assessed by the trustees would be received by the Commissioner tax-free; and such sum of \$122,371.37 could be said, in 1936, to have been constructively re-

ceived by it when it was still subject to the control of the Court.

Judge Disney: I remember that point, although I don't think it was ever really brought out before. I think that is true. I remember considering it in my own mind at that time.

Mr. Meitner: The supplemental order of the Court [254] on September 4, 1934 amending the original order as of August 20, 1942, in determining the income of the petitioner—that is on pages 7 and 8 of the written opinion—and if that is followed, which was considered in the income of 1936, that constitutes gross income for that year—the (a) order corrects it; then the (b) order shows the gross income for the year 1936, shown in the supplemental order on September 4, is contrary to that item. We raise that question in our recomputation so it is brought to the attention of the Court.

Judge Disney: It will be considered.

Mr. Meitner: Then, of course, any ruling on the 1936 as pointed out in the recomputation would affect the year 1937.

Other than that, your Honor, I think the questions are all presented in our recomputation.

Judge Disney: Anything further from the Respondent?

Mr. Whitley: Nothing further, your Honor. The Respondent has simply followed the supplemental order of the Court in his computation of depletion, and I think that will be clear enough—it is clearly set forth and I don't think any further explanation is necessary on the part of Respondent.

Judge Disney: What do you say about this sum of [255] \$122,371.37 not being constructively received by petitioner in the year 1936?

Mr. Whitley: I think, your Honor, the opinion states definitely what the net income and the gross income was, and those are exactly the figures the Respondent has used in computing the deficiencies.

Judge Disney: All right. The matter will be taken under consideration and the applicability of this 1942 Act will be likewise considered; and it will probably be about two weeks before you get an order.

(Thereupon, at 9:55 o'clock a. m., May 5th, 1943, the hearing on the above matter was concluded.)

[Endorsed]: T. C. U. S. Filed May 8, 1943.

[256]

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[Title of Tax Court and Cause.]

### ORDER

The Court having entered its order herein upon December 4, 1942, and certain amounts and figures set forth in paragraph (b) of said order having been inadvertently and erroneously used, it is

Ordered: That paragraph (b) of said order of December 4, 1942, be, and the same is hereby, modified to read as follows:



“(b) The following be included in the findings of fact:

‘The gross income, operating expenses and net income of petitioner in 1936 and 1937 from the wells shown were as follows:

Well No.	Gross Income*		Operating Expenses		Net Income or Net Loss	
	1936	1937	1936	1937	1936	1937
1	\$ 84,407.54	\$ 60,222.92	\$ 43,683.20	\$ 7,393.66	\$ 40,724.34	\$ 52,829.26
2	93,577.76	50,648.61	51,184.71	8,004.45	42,393.05	42,644.16
3	80,343.88	38,021.64	49,689.07	8,087.04	30,654.81	29,934.60
11	29,030.10	11,323.87***	43,821.86	4,477.39	14,791.76**	15,801.26**
16	46,981.24	26,783.53	26,292.37	10,723.51	20,688.87	16,060.02
17	48,406.38	29,614.72	22,984.07	8,268.25	25,422.31	21,346.47
Kern Lease		7,673.70		27,920.03		20,246.33**
						[257]

\*Gross Income does not include discounts and amounts realized from sales of junk, aggregating \$2,073.50, which amounts are not depletable.

\*\*Net Loss.

\*\*\*Loss, of which \$11,621.06 carried over as part of loss during trustee operation.’ ”

It is

Further Ordered: That the parties submit recomputations under Rule 50, in accordance with the findings of fact of this Court as amended and supplemented by this order.

(Seal) (S) R. L. DISNEY

Judge.

Dated: Washington, D. C., July 30, 1943. [258]

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[Title of Tax Court and Cause.]

PETITIONER'S RECOMPUTATION FOR  
ENTRY OF DECISION

The attached proposed recomputation is submitted on behalf of the petitioner, to The Tax Court of the United States (formerly the United States Board of Tax Appeals), in compliance with its opinion determining the issues in this proceeding.

This computation is submitted in accordance with the findings of fact and opinion of the Court, without prejudice to the petitioner's right to contest the correctness of the decision entered herein by the

Court, pursuant to the statutes in such cases made and provided.

(Signed) HAROLD C. MORTON  
Attorney for Petitioner

(Signed) GEO. F. MEITNER  
Certified Public Accountant  
for Petitioner

Of Counsel:

B. W. BURKHEAD, ESQ.,  
Los Angeles, Calif.  
December 30, 1943.

[Endrosed]: T. C. U. S. Filed Jan. 1, 1944.  
[259]

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## RECOMPUTATION STATEMENT

In Re: Barnhart-Morrow Consolidated, 1020 Subway Terminal Building, 417 South Hill Street, Los Angeles, California

Docket No. 105,859

### Income Tax Liability

Year	Tax Liability	Tax Assessed	Deficiency
1936	\$ 4,342.62	none	\$ 4,342.62
1937	15,887.41	none	15,887.41

A recomputation of the income tax liabilities of the Petitioner for the years 1936 and 1937 has been made, as hereinafter set forth in the attached schedules, pursuant to the findings of fact of the United States Board of Tax Appeals (now The Tax Court of the United States) and its opinion promulgated August 20, 1942, which was amended and supple-

mented by an order dated December 4, 1942, which order was subsequently amended by order dated July 30, 1943.

The decision as amended held as follows:

1. That the debt of \$16,500.00 was ascertained to be worthless and charged off in 1936, is an allowable deduction.

2. That the amount of salary of \$7,000.00 cancelled in 1936 does not constitute taxable income to the petitioner in that year.

3. That the petitioner has failed to prove that it was insolvent at any time during that period within the meaning of Section 14 (d) (2) of the Revenue Act of 1936.

4. That the amount paid to petitioner in 1936, plus the amount of income which had been expended for operating expenses, constitutes gross income received from the property by petitioner in 1936 for depletion purposes.

5. That petitioner may not deduct any amount as a loss, on account of failure to prove the cost of the property on abandonment of oil well number 16.

[260]

Taxable Year Ended December 31, 1936

Schedule 1

Net Income

Net income disclosed by the Statutory Notice of deficiency dated September 18, 1940.....	\$103,901.78
As adjusted in accordance with the Tax Court's Finding of Facts and opinion as amended—Exhibit A herewith .....	36,173.98
Difference (decrease) .....	<u><u>\$ 67,727.80</u></u>

Represented by :

Increases

(a) ..... none

Decreases

(b) Depletion .....\$ 32,319.17

(c) Bad Debt ..... 16,500.10

(d) Accrued Salary ..... 7,000.00

(e) Receivership Expenses .....\$17,574.68

Less—Amount allowed

by Respondent ..... 5,666.15

Additional Allowable ..... 11,908.53

Net decrease ..... \$ 67,727.80

## Schedule 2

### Explanation of Adjustments

(a) and (b) On July 30, 1943 the Court issued a second order amending the order dated December 4, 1942 which order amended and supplemented the Court's (Board's) opinion promulgated under date of August 20, 1942. The statement submitted by the Court in the order of July 30, 1943 determined the aggregate gross income from all oil wells for the year 1936 to be \$382,746.90; operating expenses to be \$237,655.28 and the aggregate net income before allowance for depletion to be \$145,091.62, details of which are set forth in Exhibit A herewith. Depletion allowance (Exhibit A) is \$79,941.69; that previously allowed by Respondent was \$47,622.52 making additional depletion allowable of \$32,319.17.

(c) and (d) Bad debt and accrued salary cancelled allowed in accordance with the Court's opinion.



(e) The income and expenses of petitioner for the year 1936 as amended was determined by the Court, in accordance with its Findings of Fact, pages 7 and 8 of opinion promulgated August 20, 1942, to include Receivership Expenses amounting to \$17,574.68. The Receivership Expenses allowed by the Respondent amount to \$5,666.15 making an additional amount allowable of \$11,908.53. [261]

## Schedule 3

## Computation of Tax—Year ended December 31, 1936

No excess-profits tax due since the first capital stock tax year ended June 30, 1937.

## Normal Tax

Net income as corrected—Schedule 1.....\$ 36,173.98

Normal tax net income ..... 36,173.98

8% on \$ 2,000.00.....\$ 160.00

11% on 13,000.00..... 1,430.00

13% on 21,173.98..... 2,752.62

Normal Tax ..... \$ 4,342.62

## Surtax on Undistributed Profits

Net income as corrected .....\$36,173.98

Less: Normal Tax ..... 4,342.62

Adjusted net income .....\$31,831.36

Dividends paid ..... none

Undistributed net income .....\$31,831.36

7% on \$ 5,000.00.....\$ 350.00

12% on 3,183.13..... 381.97

17% on 6,366.26..... 1,082.26

22% on 6,366.26..... 1,400.58

27% on 10,915.71..... 2,947.24

\$ 31,831.36

Surtax .....	6,162.05
<hr/>	
Total income tax .....	\$ 10,504.67
Income Tax assessed .....	none
Tentative Tax liability .....	\$ 10,504.67
<hr/> <hr/>	

Section 501(a) (2) and (3) of the Revenue Act of 1942 amending Sections 14(a) and 26 of the Revenue Act of 1936 has the effect of allowing for the taxable year 1936 and 1937 a credit, in the case of deficit corporations, for statutory net income which could not be distributed as a dividend because prohibited by law.

Petitioner contends that it was prohibited from declaring dividends in the year 1936 by the prohibition contained in Section 346 (2) Civil Code of the State of California.

The issue was not raised in the Petition of Petitioner since no relief was available until the passage by Congress of the Revenue Act of 1942 and which Act was passed after date of the trial of the case herein. Since Section 501 (a) (2) and (3) of the Revenue Act of 1942 was made retroactively applicable, the tax liability of the Petitioner for the year 1936 must be determined in accordance with the laws applicable thereto.

Section 346 of the Civil Code of the State of California reads as follows:

“Sec. 346. Cash or Property Dividends. A corporation may declare dividends payable in cash or in property only as follows:

(1) Out of earned surplus; or

(2) Despite the fact that the net assets of the

corporation amount to less than the stated capital, out of net profits earned during the preceding accounting period which shall not be less than six months nor more than one year in duration; or

(3) Out of paid-in surplus or surplus arising from reduction of stated capital subject to the provisions of section 348b, Civil Code, only upon shares entitled to preferential dividends; provided that notice shall be given to the shareholders receivable such dividends of the source thereof prior to or concurrently with the payment thereof.

“Impaired Assets. If the value of the net assets amounts to less, through depreciation, depletion, leases, or otherwise, than the aggregate amount of stated capital attributed to shares having liquidation preferences, the corporation shall not declare dividends out of net profits pursuant to subdivision (2) of this section, except upon such shares, until the value of the net assets has been restored to such aggregate amount of the stated capital attributed to outstanding shares having liquidation preferences.

“Dividends. No dividends shall be declared when there is reasonable ground for believing that thereupon the corporation’s debts and liabilities would exceed its assets or that it would be unable to meet its debts and liabilities as they mature. [263]

“No dividends shall be declared out of the mere appreciation in the value of its assets not yet realized, nor shall any dividends be declared from earned surplus representing profits derived from an exchange of assets unless and until such profits have

been realized or unless the assets received are currently realizable in cash.

“Wasting Asset Corporation. A wasting asset corporation, that is a corporation engaged solely or substantially in the exploitation of mines, oil wells, gas wells, patents or other wasting assets, or organized solely or substantially to liquidate specific assets, may distribute the net income derived from the exploitation of such wasting assets or the net proceeds derived from such liquidation without making any deduction or allowance for the depletion of such assets incidental to the lapse of time, consumption, liquidation or exploitation; subject, however, to adequate provision for meeting debts and liabilities and the liquidation preferences of outstanding shares and to notice to shareholders that no deduction or allowance has been made for such depletion. (Added by Stats. 1931, p. 1803; Amended by Stats. 1933, p. 1384.)”

Since the petitioner's accounting period is on the calendar year basis and since its preceding accounting period ending on December 31, 1935 showed a loss of \$6,063.64, and further, since petitioner's "Surplus" on December 31, 1935 was a deficit of \$172,161.65 (pages 6 and 7 of the written opinion promulgated August 20, 1942) that no liability for Surtax on Undistributed Profits for the year 1936 exists.

Accordingly petitioner sets forth herein its liability for income taxes for the year 1936 to be the amount of its normal income tax amounting to \$4,342.62 as submitted herein.

Taxable year Ended December 31, 1937

## Schedule 4

## Net Income

Net Income disclosed by the statutory notice of deficiency dated September 18, 1940.....	\$61,795.85
As adjusted in accordance with the Tax Court's Findings of Facts and opinion as amended—Exhibit "B" herewith .....	62,013.25
Difference (Increase) .....	\$ 217.40

Represented by:

Increases	
(a) Depletion .....	\$ 217.40
	[264]

## Schedule 5

## Explanation of Adjustments

(a) Refer to explanation (a) and (b) of schedule 2 herewith first sentence. The statement submitted by the Court in the order dated July 30, 1943 determined the aggregate gross income from all oil wells for the year 1937 to be \$201,641.25; operating expenses to be \$74,874.33 and the aggregate net income before allowance for depletion to be \$126,766.92, details of which are set forth in Exhibit B herewith. Depletion allowable Exhibit (B) is \$56,455.14; that previously allowed by Respondent was \$56,672.54, making an overallowance for depletion of \$217.40.



## Schedule 6

Computation of Tax—Year ended December 31, 1937

## Excess Profits Tax

Net Income for excess profits computation.....\$ 62,013.25

Value of capital stock de-  
clared in capital stock  
tax return filed for the  
year ended June 30,  
1937 .....\$800,000.00

10% of Declared Value..... 80,000.00

Dividends Received credit  
85% of \$14,026.50 ..... 11,922.52

Total ..... \$91,922.52

Balance subject to tax..... none

Excess Profits Tax ..... none

## Normal Tax

Net Income; schedule 4 .....\$ 62,013.25

Less: Dividends received credit (85%) of  
\$14,026.50 ..... 11,922.52

Normal-tax net income ..... \$ 50,090.73

8% on \$ 2,000.00 .....\$ 160.00

11% on 13,000.00 ..... 1,430.00

13% on 25,000.00 ..... 3,250.00

15% on 10,090.73 ..... 1,513.61

Normal Tax ..... \$ 6,353.61

[265]

## Surtax on Undistributed Profits

Net Income, Schedule 4.....	\$62,013.25	
Less: Normal tax as above.....	6,353.61	
<hr/>		
1. Adjusted net income .....	55,659.64	
Less: Dividends paid credit.....	6,949.77	
<hr/>		
2. Undistributed net income.....	\$48,709.87	
3. Portion taxable at 7% :		
\$5,000.00 or 10% of		
\$55,659.64 whichever is		
greater .....	\$ 5,565.96	389.62
4. Portion taxable at 12% :		
10% of item 1 (But not		
more than item 2 minus		
item 3) .....	5,565.96	667.92
5. Portion taxable at 17% :		
20% of item 1 (But not		
more than item 2 minus		
items 3 and 4).....	11,131.92	1,892.43
6. Portion taxable at 22% :		
20% of item 1 (But not		
more than item 2 minus		
items 3 to 5) .....	11,131.92	2,449.02
7. Portion taxable at 27% :		
Item 2 minus items 3		
to 6 .....	15,314.11	4,134.81
<hr/>		
Surtax.....	\$	9,533.80
<hr/>		
Total income tax liability.....	\$	15,887.41
Income tax assessed .....		none
<hr/>		
Deficiency .....	\$	15,887.41
<hr/>		

## gs Lease

Well No. 11	Well No. 16	Well No. 17
(13,579.12)	\$ 22,758.60	\$ 25,834.49
41,885.12	21,606.71	20,992.14

## EXHIBIT A

## BARNHART-MORROW CONSOLIDATED

YEAR 1936

GROSS INCOME	Total	Santa Fe Springs Lease					
		Well No. 1	Well No. 2	Well No. 3	Well No. 11	Well No. 16	Well No. 17
Impounded Funds							
Distributions in 1936	\$142,989.99	\$ 38,039.82	\$ 40,323.67	\$29,612.53	\$(13,579.12)	\$ 22,758.60	\$ 25,834.49
Expenses of operations	223,352.83	41,732.64	49,309.34	47,826.88	41,885.12	21,606.71	20,992.14
Total Impounded Funds	366,342.82	79,772.46	89,633.01	77,439.41	28,306.00	44,365.31	46,826.63
Less discounts and amounts realized from sale of Junk, (see below)	1,116.52	184.74	184.74	184.74	192.81	184.74	184.75
Gross Income from Impounded Funds	365,226.30	79,587.72	89,448.27	77,254.67	28,113.19	44,180.57	46,641.88
Oil and Gas Sales in 1936	17,520.60	4,819.82	4,129.49	3,089.21	916.91	2,800.67	1,764.50
Total Gross Income	382,746.90	84,407.54	93,577.76	80,343.88	29,030.10	46,981.24	48,406.38
EXPENSES							
Impounded Funds	233,352.83	41,732.64	49,309.34	47,826.88	41,885.12	21,606.71	20,992.14
Oil and Gas Sales	14,302.45	1,950.56	1,875.37	1,862.19	1,936.74	4,685.66	1,991.93
Total Expenses	237,655.28	43,683.20	51,184.71	49,689.07	43,821.86	26,292.37	22,984.07
NET INCOME BEFORE DEPLETION	145,091.62	40,724.34	42,393.05	30,654.81	(14,791.76)	20,688.87	25,422.31
DEPLETION							
27½% of Gross Income limited to 50% of Net Income. (See below)	79,941.69	20,362.17	21,196.52	15,327.41	.....	10,344.43	12,711.16
NET INCOME AFTER DEPLETION	65,149.93	\$ 20,362.17	\$ 21,196.53	\$ 15,327.40	\$(14,791.76)	\$ 10,344.44	\$ 12,711.15
OTHER INCOME							
Rental on Drilling Equipment	5,000.00						
Claim for interest on Note Indebtedness relinquished in 1936	391.67						
Discounts and amounts realized from sale of junk	1,116.52						
Total	71,658.12						
OTHER INCOME DEDUCTIONS							
Interest Paid	1,409.36						
Loss—Payments to J. A. Smith	16,500.10						
Receivership Expenses	17,574.68						
Total Income Deductions	35,484.14						
NET TAXABLE INCOME	\$ 36,173.98						
DEPLETION							
27½% of Gross Income		\$ 23,212.07	\$ 25,733.88	\$ 22,094.56	.....	\$ 12,919.84	\$ 13,311.75
50% of Net Income before allowance for Depletion		20,362.17	21,196.52	15,327.41	.....	10,344.43	12,711.16
Depletion Allowable		20,362.17	21,196.52	15,327.41	.....	10,344.43	12,711.16

Note: Figures in parentheses are red (loss) figures.

## EXHIBIT B

## BARNHART-MORROW CONSOLIDATED

YEAR 1937

GROSS INCOME	Total	Santa Fe Springs Lease						Kern County Land Co. Lease
		Well No. 1	Well No. 2	Well No. 3	Well No. 11	Well No. 16	Well No. 17	
Impounded Funds								
Distributions released in the year 1937 by the Court in Julian V. Schwartz less dis- counts and amounts realized from sale of \$122,371.37		\$ 32,554.62	\$ 34,509.14	\$ 25,342.52	\$(11,621.06)	\$ 19,476.90	\$ 22,109.25	
junk. (See below) .....	955.50	158.10	158.10	158.10	165.00	158.10	158.10	
Gross Income from Impounded Funds..	121,415.87	32,396.52	34,351.04	25,184.42	(11,786.06)	19,318.80	21,951.15	
Oil and Gas Sales in 1937.....	80,225.38	27,826.40	16,297.57	12,837.22	462.19	7,464.73	7,663.57	7,673.70
Total Gross Income .....	201,641.25	60,222.92	50,648.61	38,021.64	(11,323.87)	26,783.53	29,614.72	7,673.70
EXPENSES								
Oil and Gas Sales .....	74,874.33	7,393.66	8,004.45	8,087.04	4,477.39	10,723.51	8,268.25	27,920.03
NET INCOME BEFORE DEPLETION.....	126,766.92	52,829.26	42,644.16	29,934.60	(15,801.26)	16,060.02	21,346.47	(20,246.33)
DEPLETION								
27½% of Gross Income limited to 50% of net income (see below) .....	56,455.14	16,561.30	13,928.37	10,455.95	.....	7,365.47	8,144.05	.....
NET INCOME AFTER DEPLETION .....	70,311.78	36,267.96	28,715.79	19,478.65	(15,801.26)	8,694.55	13,202.42	(20,246.33)
OTHER INCOME								
Distributions received on Oil Participating Agreements in Julian Wells Nos. 1, 2 and 3, being dividends received for the year 1937	14,026.50							
Cash discounts received .....	505.69							
Discounts and amounts realized from sale of junk. (See above) .....	955.50							
Income from sale of Miscellaneous Casing.....	121.42							
Income for drilling oil well for others.....	3,000.00							
Total.....	88,920.89							
OTHER INCOME DEDUCTIONS								
Loss sustained on Davies Well No. 1 aban- doned on April 27, 1937.....	23,818.13							
Interest Paid .....	3,089.51							
Total Income Deductions .....	26,907.64							
NET TAXABLE INCOME .....	\$ 62,013.25							
DEPLETION								
27½% of Gross Income .....		\$ 16,561.30	\$ 13,928.37	\$ 10,455.95	.....	\$ 7,365.47	\$ 8,144.05	\$ 2,110.27
50% of Net Income before allowance for de- pletion .....		26,414.63	21,322.08	14,967.30	.....	8,030.01	10,673.23	.....
Depletion Allowable .....		16,561.30	13,928.37	10,455.95	.....	7,365.47	8,144.05	.....

Note: Figures in Parentheses are red (loss) figures.

Geo. F. Meitner &amp; Co., Auditors and Accountants

[Endorsed]: T.C.U.S Filed Jan. 1, 1944. [268]





The Tax Court of the United States  
Washington

Docket No. 105859

BARNHART-MORROW CONSOLIDATED,  
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

DECISION

Pursuant to the Court's Findings of Fact and Opinion promulgated August 20, 1942, modified by orders dated December 4, 1942, and July 30, 1943, both parties filed computations, which came on for hearing on January 5, 1944. Same having been duly considered, it is

Ordered and Decided: That for the year 1936 there is a deficiency in income tax consisting of normal tax of \$6,052.38 and surtax on undistributed profits of \$8,456.79, making a total deficiency of \$14,509.17; and that for the year 1937 there is a deficiency in income tax consisting of \$6,353.61, limited however to \$6,321.00, the amount determined in the deficiency notice, and surtax on undistributed profits of \$9,533.80, limited however to \$9,495.89, the amount determined in the deficiency notice, making a total deficiency of \$15,816.89.

(Signed) R. L. DISNEY,

Judge.

Entered Jan. 24, 1944. [269]

[Title of Tax Court and Cause.]

MOTION FOR REHEARING AND VACATING  
DECISION ENTERED JANUARY 24, 1944

Now comes the Petitioner in the above entitled and numbered proceeding and respectfully moves The Tax Court of the United States (formerly the United States Board of Tax Appeals) for a rehearing of this matter and to vacate the Decision of the Division entered under date of January 24, 1944, for the following reasons:

1. Section 501 (a) (2) and (3) of the Revenue Act of 1942, amending Sections 14(a) and 26 of the Revenue Act of 1936, has the effect of allowing a credit for the taxable years 1936 and 1937, in the case of deficit corporations, for statutory net income, which could not be distributed as a dividend because prohibited by law. [270]

Petitioner contends that it was prohibited by law from declaring dividends in the year 1936 by the prohibition contained in Section 346, Civil Code of the State of California.

The issue was not raised in the Petition of Petitioner, since no relief was available under such circumstances, until the passage by Congress of the Revenue Act of 1942 and which Act was passed after date of the trial on the merits of the case herein. Since Section 501 (a) (2) and (3) of the Revenue Act of 1942 was made retroactively applicable to the years involved in this matter, it is contended by the Petitioner that the tax liability for the year 1936 must be determined in accordance with the

laws applicable thereto in order to avoid an injustice to the Petitioner.

Certain facts sustaining Petitioner's contention are now in the record and additional facts to further substantiate Petitioner's contention in the application of Section 501 of the Revenue Act of 1942, which facts were not material to the issues involved at the time of the hearing, will be presented to the Court at such rehearing of the matter. The additional evidence that will be submitted will be an analysis of the Deficit Account sustaining Petitioner's contention that such "deficit existed in accumulated earnings and profits as of the close of the preceding taxable year," for purpose of Section 501.

[271]

The applicability of Section 501 of the Revenue Act of 1942 was called to the attention of the Court in Petitioner's computation for entry of decision under Rule 50, dated March 24, 1943 and hearing had thereon May 5, 1943.

Pursuant to supplemental order of the Court, dated July 30, 1943, Petitioner's Recomputation under Rule 50, dated December 30, 1943, and Memorandum in Support of Rule 50 Recomputation, dated January 3, 1944, were filed with the Court and therein the attention of the Court was directed again to the applicability of Section 501 of the Revenue Act of 1942 to the year 1936.

Since no additional finding of fact was made with respect to the applicability of Section 501 of the Revenue Act of 1942, nor mention thereof made or reflected in the determination of the tax liability in

the Decision of the Division entered January 24, 1944, it now appears that no consideration was given to the applicability of said Section, or, if consideration were given, it could not have been properly considered at that time since the Exhibits, reflecting the facts in the record pertaining to this issue and to which Exhibits Petitioner referred to in its recomputation statement and memorandum in support thereof, were not before the Court at any time between the filing of Petitioner's memorandum in support of Rule 50 recomputation and January 24, 1944, the date of [272] the Decision. This absence of the Exhibits was due to an error of the Clerk of this Court in mailing all of the Exhibits to counsel for Petitioner at Los Angeles, California, on November 2, 1943, as appears from the Affidavit of Harold C. Morton, attached hereto, made a part hereof and marked Exhibit "A", and as further appears from the Affidavit of Ruby Spicer, attached hereto, made a part hereof and marked Exhibit "B". Said memorandum had been filed in lieu of oral argument, due to the inability of Petitioner's counsel to be present on the date set by this Court for hearing under Rule 50.

2. The Decision of the Division with respect to the issue involving whether or not the Petitioner was insolvent during the year 1936 and the Opinion rendered that the Petitioner was not insolvent for said year are contrary to the stipulations by the parties, to the Exhibits in the record, and to the findings of fact. The balance sheet of the Petitioner at the close of the year 1935 shows an item



“Capital Stock issued for services and leases, \$219,120.50,” (page 7 of Opinion promulgated August 20, 1942.) This item, the Opinion misconstrues to be stock owned by the Petitioner and under its control, having a book value of about \$220,000.00 (page 13 of Opinion promulgated August 20, 1942.) Such item, in fact, represents capital stock issued by the Petitioner, and not [273] stock issued to it, and, therefore, cannot be stock owned by it. Since the item does not represent stock owned by the Company, it could not be used as security for a loan nor sold to pay debts, as stated in the Opinion (page 13). The misapprehension of this item by the Court is based upon an assumption that the item represents stock owned by the Petitioner, which it could have used for credit purposes or sold in order to pay its debts. The “insolvency issue” was stated at length in the “Motion and Application for Reconsideration of Decision or Rehearing and For Additional Findings” heretofore filed with the Court in September, 1942, and to which the attention of the Court is directed.

3. The Decision of the Division, pertaining to the year 1936, is contrary to the stipulations in the record and the findings of fact (pages 7 and 8 of Opinion promulgated August 20, 1942) with respect to Receivership Expenses amounting to \$17,574.68, by not allowing as an additional deduction from income of that year the sum of \$11,908.53.

4. The Opinion promulgated August 20, 1942 and the decision rendered pursuant thereto are contrary to the stipulated facts and testimony in the

record with respect to the disallowance as a loss deduction in the year 1937 of the loss claimed by Petitioner in connection with the [274] relinquishment of its interest in Well No. 16. The assumption by the Court with respect to the disposition made on the records of the Petitioner or in its prior income tax returns, concerning issues which it raises in connection with items appearing on Exhibit 57, assumes as a conclusion that a prior tax benefit was received by the Petitioner, which assumption or conclusion is not supported by the evidence in the record and is contrary to the actual facts, stipulations and testimony in the record.

5. The Exhibits of Petitioner, filed with the stipulation of facts or introduced in evidence at the hearing on the merits, were not before the Court from November 2, 1943, to January 24, 1944, during which time there were filed for consideration Petitioner's Recomputation Under Rule 50 and Memorandum In Support Thereof (in lieu of oral argument on recomputation), which refer to various of said Exhibits and which were based thereon (Affidavits of Harold C. Morton and Ruby Spicer attached hereto). The foregoing, Petitioner respectfully submits, prevented a full and fair consideration of Petitioner's Recomputation Under Rule 50 and Memorandum In Support Thereof.

Wherefore, Petitioner respectfully prays that this Court vacate the Decision herein, dated January

24, 1944, [275] and direct and order that a rehearing be had of this matter.

(Signed) HAROLD C. MORTON,  
Attorney for Petitioner,  
1126 Pacific Mutual Building,  
523 West Sixth Street,  
Los Angeles, 14, California.

(Signed) GEO. F. MEITNER,  
Certified Public Accountant  
for Petitioner,  
711 Wright and Callender  
Building,  
405 South Hill Street,  
Los Angeles, 13, California.

Of Counsel:

B. W. BURKHEAD, ESQ.

Los Angeles, California, February 15, 1944. [276]

EXHIBIT "A"

[Title of Tax Court and Cause.]

AFFIDAVIT OF HAROLD C. MORTON

State of California,

County of Los Angeles—ss.

Harold C. Morton, being first duly sworn, deposes and says:

That he is a member of the law firm of Hanna and Morton, with offices located at 1126 Pacific Mutual Building, 523 West Sixth Street, Los Angeles, 14, California;

That B. W. Burkhead, Esquire, formerly was associated with the firm of Hanna And Morton; that said B. W. Burkhead has been in the Armed Forces for many months last past;

That on February 14, 1944, Ruby Spicer, an employee of the firm of Hanna And Morton, called to the attention of affiant a letter, dated January 27, 1944, written by the Honorable B. D. Gamble, Clerk of the Tax Court of the United [277] addressed to B. W. Burkhead, Esq., wherein a request was made for the return of certain original documents, being Petitioner's exhibits in this case, which, through inadvertence, had been mailed in November, 1943, by the Clerk of this Court to the said B. W. Burkhead; a copy of said letter of January 27, 1944, is hereunto attached, made a part hereof and marked Exhibit "1"; by transmittal letter, dated February 15, 1944, affiant answered said letter of the Clerk, dated January 27, 1944, and returned to him the original Petitioner's exhibits in this case;

Affiant did not know that the envelope from the United States Tax Court, addressed to the said B. W. Burkhead, which was received by this office on November 6, 1943, contained the original Petitioner's exhibits in this case; upon the receipt at that time of such envelope, affiant was advised by Ruby Spicer, an employee of the firm of Hanna And Morton, that an envelope had been received from the United States Tax Court, addressed to B. W. Burkhead, Esq., containing a large number of papers pertaining to Barnhart-Morrow Con-

solidated, and affiant, without examining the documents therein contained, instructed the said Ruby Spicer to place the same in the office file of Hanna And Morton pertaining to Barnhart-Morrow Consolidated. [278]

Because of inability of counsel for Petitioner to be present on January 5, 1944, at the time set for hearing under Rule 50, Petitioner filed a Memorandum In Support of Recomputation Under Rule 50, in lieu of personal appearance; said Memorandum referred to and relied upon various of said Exhibits and could not be fully and fairly considered by the Court without the presence of said Exhibits.

Further, affiant sayeth not.

(Signed) HAROLD C. MORTON

1126 Pacific Mutual Building,  
523 West Sixth Street, Los  
Angeles, 14, California

Subscribed and Sworn to before me this 15th day of February, 1944.

[Notarial Seal] LAURA TEETER

Notary Public in and for the County of Los Angeles, State of California.

My Commission Expires July 21, 1947. [279]



EXHIBIT "1" TO EXHIBIT "A"

The Tax Court of the United States  
Washington

January 27, 1944.

B. W. Burkhead, Esq.,  
1126 Pacific Mutual Bldg.,  
Los Angeles, California.

In re: Barnhart-Morrow Consolidated,  
Docket Number 105,859

Sir:

Through clerical error petitioner's exhibits 1 through 55, letters and statements, 56, stipulation to dismiss, 57, statement of loss on oil wells, 58, gross proceeds of production, 59, statement 2 pages, 60, statement, 61, statement were returned to you November 2, 1943.

Under the circumstances I am obliged to request the return to this office of said petitioner's exhibits.

I regret very much any annoyance this error may cause.

Respectfully,

(Signed)      B. D. GAMBLE,  
Clerk [280]

BDG/cgh

For Victory Buy United States War Bonds and  
Stamps.

## EXHIBIT "B"

[Title of Tax Court and Cause.]

## AFFIDAVIT OF RUBY SPICER

State of California,

County of Los Angeles—ss.

Ruby Spicer, being first duly sworn, deposes and says:

That she is an employee of the law firm of Hanna And Morton, which has its offices at 1126 Pacific Mutual Building, 523 West Sixth Street, Los Angeles, 14, California;

That Mr. B. W. Burkhead, counsel in the above-entitled matter, formerly was associated with the firm of Hanna And Morton, but is now in the Armed Forces of the United States of America and has been for many months last past;

That on November 6, 1943, there was received in the Office of Hanna And Morton, sent by ordinary mail, an envelope (no letter or other communication being enclosed), [281] addressed to B. W. Burkhead, Esq., 1126 Pacific Mutual Bldg., 523 West 6th St., Los Angeles, Calif.; said envelope showed that it was from the United States Tax Court, Washington, D. C.; affiant opened the same and observed that it contained various documents pertaining to the income tax situation of Barnhart-Morrow Consolidated and thereupon placed the same in the file of this office pertaining thereto; and that said documents remained in such file in the Office of Hanna And Morton until February 15, 1944, at which time they were mailed to the Honor-

able B. D. Gamble, Clerk of The Tax Court of the United States, Washington, D. C., pursuant to a letter of request therefor, written by said Clerk under date of January 27, 1944, which said request was answered by letter returning said documents, written by Mr. Harold C. Morton of the firm of Hanna And Morton under date of February 15, 1944.

Further, affiant sayeth not.

(Signed)            RUBY SPICER

Care of Hanna And Morton, 1126 Pacific Mutual  
Building, 523 West Sixth Street, Los Angeles,  
14, California.

Subscribed and Sworn to before me this 15th day  
of February, 1944.

[Notarial Seal]

(Signed)            LAURA TEETER

Notary Public in and for the County of Los An-  
geles, State of California.

My Commission Expires July 21, 1947.

[Endorsed]: T.C.U.S. Filed Feb. 17, 1944. [282]

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[Title of Tax Court and Cause.]

### ORDER

Petitioner having filed its motion for rehearing and to vacate decision entered herein on January 24, 1944, the record in this case has again been fully examined and studied. All of the matters presented by the present motion had, prior to the filing thereof, been thoroughly considered. On December 4, 1942, motion filed September 17, 1942, for rehearing,

including consideration of the issues now raised as to loss on Well No. 16 and insolvency, was denied. The matter of receivership expense was waived at the original hearing, and was not discussed in petitioner's briefs nor at the hearing under Rule 50. The above issues were nevertheless reconsidered because the figures involved were incorporated in the recomputations submitted.

The opinion was promulgated on August 20, 1942, prior to the approval, on October 21, 1942, of the Revenue Act of 1942. No motion was filed to apply section 501 (a) (2) and (3) of that Act, by presentation of additional evidence or otherwise, nor any application made to amend the pleadings to cover the issue. The question of whether, under such section, petitioner was a deficit corporation on [283] December 31, 1935, was first suggested, and the petitioner's contention thereon first set forth in a Rule 50 recomputation filed by the petitioner on March 26, 1943, by reference to the balance sheet of December 31, 1935, as set forth in the findings of fact. The necessity for further evidence on the issue was not alleged. The respondent filed his recomputation and memorandum, presenting opposition to deficit credit, and pointing out that the issue had not theretofore been presented prior to Rule 50 recomputation. On May 5, 1943, the Court, after continuance at petitioner's request, heard both parties, through counsel, upon the recomputations submitted, including the question of applicability of section 501, and the petitioner then submitted the matter upon the facts already in the record, and

elected not to file a memorandum on the subject, stating that the facts were in the record. The record, as shown in the findings of fact, then contained the balance sheet of the petitioner at the crucial date, the close of 1935. Upon the evidence of record and after due consideration thereof, and of the question of the applicability of section 501 of the Revenue Act of 1942, the Court on July 30, 1943, entered its order modifying and supplementing the original findings of fact and requiring the parties to submit recomputations under Rule 50, in accordance with such amended and supplemented findings of fact. Revised recomputations were filed on November 18, 1943, by the respondent, and upon January 1, 1944, by the petitioner. The application of section 501 was again presented in petitioner's recomputation, with no suggesiton of additional evidence being necessary, and petitioner's contention set forth again in its memorandum filed January 7, 1944. The matter came on for hearing on January 5, [284] 1944, after constinuanace at petitioner's request. On January 24, 1944, after full consideration of all matters, the Court entered the decision to which petitioner's motion is directed. By inadvertence of the Clerk of the Court, the exhibits had been mailed to counsel for the petitioner on November 2, 1943, including Exhibit 51, which includes the balance sheet of petitioner at the close of the year 1935. Such exhibits were returned to the Court on February 19, 1944. The present motion suggests the absence of such exhibits as indicative of lack of consideration by the Court of



the applicability of section 501 of the Revenue Act of 1942. The assumption is without foundation, and such absence of the exhibits was of no effect for the reason that the only record evidence affecting the question of deficit corporation and section 501 of the Revenue Act of 1942, to wit, the balance sheet as at the close of 1935, was contained in the original findings of fact of the Court, and before it during the absence of the exhibits, and further because the matter had been thoroughly considered prior to the mailing of the exhibits to the petitioner, after submission of the question upon such evidence at the hearing on May 5, 1943. The decision of January 24, 1944, contained no recitations in connection with the question, for the reason that it had been presented only upon recomputation for decision under Rule 50, which is a rule for ascertainment of the parties' figures on the case as it stands determined, after disposition of any applications for rehearing, reconsideration, or modification. It was considered neither necessary nor proper to set out in a decision an opinion upon the deficit credit point, and the figures decided upon necessarily reflected the conclusion thereon. [285]

The present motion raises no question not already examined and considered over a long period, and so far as suggestion of new evidence is concerned, comes after petitioner's decision on May 5, 1943, to stand upon the original evidence. The only additional evidence now suggested by motion is an analysis of the deficit account. Nothing newly discovered, since the hearing on the issue on May 5,

1943, is suggested. The record evidence has, upon the earlier presentations of the question, been found insufficient to show right to the deficit corporation credit. In the light of the entire record here, and after repeated presentation and consideration of this question, no just reason is found to vacate the decision of January 24, 1944, and the petitioner's motion is therefore denied.

(Signed) R. L. DISNEY  
Judge.

Dated: Washington, D. C., February 29, 1944.

[286]

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In the United States Circuit Court of Appeals  
for the Ninth Circuit

T. C. Docket No. 105859

BARNHART-MORROW CONSOLIDATED,  
Petitioner,  
vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

PETITION FOR REVIEW AND  
ASSIGNMENTS OR ERROR

To the Honorable Judges of the United States Circuit Court of Appeals for the Ninth Circuit:

The petition of Barnhart-Morrow Consolidated respectfully shows:

## I.

Petitioner is a corporation organized under the laws of the State of California. Its income tax returns for the calendar years 1936 and 1937 here involved were filed with the Collector of Internal Revenue for the Sixth District of California.

## II.

On September 18, 1940, respondent sent to petitioner a notice of deficiencies in income tax for the calendar years 1936 and 1937, in the sums of \$32,767.96 and \$15,816.89 respectively. Within ninety days thereafter [287] petitioner filed with the United States Board of Tax Appeals a petition for redetermination of the said asserted deficiencies. On August 20, 1942, the Board of Tax Appeals promulgated its opinion, reported in Volume 47 Board of Tax Appeal Reports, at page 590. On September 17, 1942, petitioner filed a motion for reconsideration of the opinion, or in the alternative, for a further hearing, and for additional findings. By an order dated December 4, 1942, the Board (now the Tax Court of the United States) denied the motion for reconsideration or rehearing, but corrected and made additions to the findings of fact contained in its opinion. After a hearing under Rule 50, the Tax Court on July 30, 1943, modified the additional findings contained in its order of December 4, 1942, and ordered the submission of further computations under Rule 50. The decision, entered January 24, 1944, redetermined the deficiency for 1936 at \$14,509.17 and upheld the re-

spondent's determination of a \$15,816.89 deficiency for 1937. On February 15, 1944, petitioner filed a motion to vacate the decision and for a rehearing. This motion was denied by the Tax Court in an order dated February 29, 1944, by which order the Court also decided, adversely to petitioner, two of the issues involved in this proceeding.

### III.

The nature of the controversy is as follows: [288]

(a) Petitioner contends that during a portion of the year 1936 it was insolvent and in receivership and, therefore, that for the year 1936 it was exempted from surtax on undistributed profits by Section 14(d)(2) of the Revenue Act of 1936. Respondent denies that petitioner was insolvent during any portion of said year.

(b) Petitioner contends that at the close of the year 1935 it had a deficit of \$172,161.65 in accumulated earnings and profits and was prohibited by Section 346 of the Civil Code of the State of California from paying dividends during the existence of such deficit, and, therefore, that under Sections 14(a)(2) and 26(c)(3) of the Revenue Act of 1936, as amended by Section 501(a) of the Revenue Act of 1942, it is entitled to deduct the amount of such deficit in determining its undistributed net income subject to surtax for the year 1936. Respondent contends that the evidence is insufficient to show the existence of such deficit.

(c) Petitioner contends that its liability for receivership expenses paid in 1936 in the sum of

\$17,574.68 accrued on November 12, 1936, when said expenses were approved by the Court which appointed the receiver and authorized to be paid, and therefore, that said sum is deductible under Section 23(a) of the Revenue Act of 1936 in determining net income and undistributed net income for that year. Respondent denies that petitioner is entitled to deduct \$11,908.53 [289] of the said sum of \$17,574.68 on the ground that petitioner's liability for payment of said sum of \$11,908.53 accrued in years prior to 1936.

(d) Petitioner contends that in determining net income and undistributed net income for the year 1937 it is entitled, under Section 23(f) of the Revenue Act of 1936, to deduct \$42,900.15 for the loss sustained upon relinquishment of its one-half interest in an oil well known as Well No. 16, which had been operating at a loss and which required repairs the cost of which could not be determined in advance. Respondent denies petitioner's right to this deduction on the ground that the evidence is insufficient to prove the true cost or other basis of petitioner's interest in said well.

#### IV.

Petitioner assigns as error the following acts and omissions of the Tax Court:

(1) The Court erred in holding and deciding that petitioner was not insolvent, within the meaning of Section 14(d)(2) of the Revenue Act of 1936, at any time during the year 1936.



(2) The Court erred in holding and deciding that the evidence was insufficient to show petitioner's right under Sections 14(a)(2) and 26(c)(3) of the Revenue Act of 1936, as amended by Section 501(a) of the Revenue Act of 1942, to deduct its deficit in accumulated earnings [290] and profits as of December 31, 1935, in determining undistributed net income for the year 1936.

(3) The Court erred in failing to make findings of fact with respect to petitioner's asserted right to the deduction referred to in the preceding assignment.

(4) The Court erred in denying petitioner a rehearing for the purpose of proving its right to the deduction referred to in paragraph (2) of these assignments.

(5) The Court erred in holding and deciding that petitioner was not entitled, in determining its net income and undistributed net income for the year 1936, to deduct \$11,908.53 paid in 1936 as receivership expenses.

(6) The Court erred in holding and deciding that petitioner was not entitled, in determining net income and undistributed net income for the year 1937, to deduct the loss sustained upon relinquishment of its one-half interest in Well No. 16.

(7) The Court erred in redetermining a deficiency of \$14,509.17 in petitioner's income tax and undistributed profits surtax for the calendar year 1936.

(8) The Court erred in upholding respondent's determination of a deficiency of \$15,816.89 in pe-

tioner's income tax and undistributed profits sur-tax for the calendar year 1937.

Wherefore, petitioner prays that this Honorable Court review and reverse the said decision and order of [291] the Tax Court, and remand the case for a hearing, to the end that the errors herein complained of may be corrected.

HAROLD C. MORTON

LEON B. BROWN

By /s/ LEON B. BROWN

Attorneys for Petitioner

1126 Pacific Mutual Bldg.

Los Angeles 14, California

(Duly verified.)

[Endorsed]: Filed T.C.U.S. May 15, 1944. [292]

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[Title of Circuit Court of Appeals and Cause.]

NOTICE OF FILING PETITION FOR  
REVIEW

To the Chief Counsel of the Bureau of Internal  
Revenue, Washington, D. C.

You are hereby notified that Barnhart-Morrow Consolidated did on the      day of May, 1944, file with the Clerk of the Tax Court of the United States, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Ninth Circuit of the decision of the Tax Court heretofore rendered in the above entitled case. A copy of the petition for review and assignments of

error, as filed, is hereto attached and served upon you.

Dated: May 9, 1944.

HAROLD C. MORTON

LEON B. BROWN

By /s/ LEON B. BROWN

Attorneys for said Barnhart-  
Morrow Consolidated [294]

Personal service of the above and foregoing notice, together with a copy of the petition for review and assignments of error mentioned therein, is hereby acknowledged this 16th day of May, 1944.

J. P. WENCHEL

C.A.R.

Chief Counsel

Bureau of Internal Revenue

[Endorsed]: T.C.U.S. Filed May 16, 1944. [295]

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[Title of Circuit Court of Appeals and Cause.]

#### STATEMENT OF POINTS RELIED UPON

Now comes Barnhart-Morrow Consolidated, the petitioner on review herein, and hereby asserts the following errors upon which it intends to rely in this review:

(1) The Court erred in holding and deciding that petitioner was not insolvent, within the meaning of Section 14(d)(2) of the Revenue Act of 1936, at any time during the year 1936.

(2) The Court erred in holding and deciding

that the evidence was insufficient to show petitioner's right under Sections 14(a) (2) and 26 (c) (3) of the Revenue Act of 1936, as amended by Section 501(a) of the Revenue Act of 1942, to deduct its deficit in accumulated earnings and profits as of December 31, 1935, in determining undistributed net income for the year 1936.

(3) The Court erred in failing to make findings of fact with respect to petitioner's asserted right to the deduction referred to in the preceding assignment. [296]

(4) The Court erred in denying petitioner a rehearing for the purpose of proving its right to the deduction referred to in paragraph (2) of these assignments.

(5) The Court erred in holding and deciding that petitioner was not entitled, in determining its net income and undistributed net income for the year 1936, to deduct \$11,908.53 paid in 1936 as receivership expenses.

(6) The Court erred in holding and deciding that petitioner was not entitled, in determining its net income and undistributed net income for the year 1937, to deduct the loss sustained upon relinquishment of its one-half interest in Well No. 16.

(7) The Court erred in redetermining a deficiency of \$14,509.17 in petitioner's income tax and undistributed profits surtax for the calendar year 1936.

(8) The Court erred in upholding respondent's determination of a deficiency of \$15,816.89 in pe-

tioner's income tax and undistributed profits sur-tax for the calendar year 1937.

HAROLD C. MORTON

LEON B. BROWN

By /s/ LEON B. BROWN

Attorneys for Petitioner

1126 Pacific Mutual Bldg.

Los Angeles 14, California

[297]

Service of a copy of the within statement of points is hereby admitted this 16th day of May, 1944.

J. P. WENCHEL

Chief Counsel,

Bureau of Internal Revenue

By J. P. WENCHEL

C.A.R.

Counsel for Respondent on  
Review

[Endorsed]: T.C.U.S. Filed May 16, 1944. [298]

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[Title of Circuit Court of Appeals and Cause.]

PETITIONER'S DESIGNATION OF POR-  
TIONS OF RECORD TO BE INCLUDED  
IN THE RECORD ON REVIEW

To the Clerk of the Tax Court of the United States:

You will please prepare, transmit, and deliver to the Clerk of the United States Circuit Court of Appeals for the Ninth Circuit, copies, duly certified



as correct, of the following documents and records in the above-entitled cause, for use in connection with the petition for review heretofore filed by Barnhart-Morrow Consolidated:

1. Docket entries of all proceedings before the United States Board of Tax Appeals and the Tax Court of the United States;
2. Petition of Barnhart-Morrow Consolidated, including all exhibits thereto;
3. Answer of Commissioner of Internal Revenue;
4. Stipulation of Facts;
5. Transcript of proceedings and testimony at hearing on October 4, 1941; [299]
6. Petitioner's Exhibits 47, 51, 57, 58, 59, 60, and 61, and the following portions of the cross-complaint admitted as petitioner's Exhibit 41: the title of the court and cause, the two introductory paragraphs, paragraphs IX, XVII and XX, the introductory paragraph of the prayer, and paragraphs 3, 7, 8, and 9 of said prayer;
7. Findings of fact and opinion promulgated August 20, 1942;
8. Petitioner's motion for reconsideration or rehearing and for additional findings, filed September 17, 1942, together with appendices attached;
9. Order dated December 4, 1942;
10. Petitioner's computation filed March 26, 1943;
11. Transcript of proceedings and testimony at hearing on May 5, 1943;
12. Order dated July 30, 1943;

13. Petitioner's recomputation filed on or about January 1, 1944;

14. Decision entered January 24, 1944;

15. Petitioner's motion to vacate decision and for rehearing, together with exhibits attached;

16. Order dated February 29, 1944;

17. Petition for review, with proof of service of copy of petition and of notice of filing same;

18. Petitioner's designation of portions of record to be included in the record on review; [300]

19. Petitioner's statement of points relied upon.

Said transcript is to be prepared, certified, and transmitted as required by law and the rules of the United States Circuit Court of Appeals for the Ninth Circuit.

HAROLD C. MORTON

LEON B. BROWN

By /s/ LEON B. BROWN

Attorneys for Petitioner  
on Review

1126 Pacific Mutual  
Building

Los Angeles 14, California

Service of a copy of the within designation is hereby acknowledged this 16th day of May, 1944.

J. P. WENCHEL

Chief Counsel, Bureau of In-  
ternal Revenue

By J. P. WENCHEL

C.A.R.

Counsel for Respondent on  
Review

[Endorsed]: T.C.U.S. Filed May 16, 1944. [301]

The Tax Court of the United States  
Washington

Docket No. 105859

BARNHART-MORROW CONSOLIDATED,  
Petitioner,  
v.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

CERTIFICATE OF CLERK

I, B. D. Gamble, clerk of The Tax Court of the United States do hereby certify that the foregoing pages, 1 to 301, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praeceptum in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of The Tax Court of the United States, at Washington, in the District of Columbia, this 31st day of May, 1944.

[Seal]

B. D. GAMBLE, Clerk,  
The Tax Court of the United  
States.

[Endorsed]: No. 10806. United States Circuit Court of Appeals for the Ninth Circuit. Barnhart-Morrow Consolidated, a corporation, Petitioner, vs. Commissioner of Internal Revenue, Respondent. Transcript of the Record. Upon Petition to Review a Decision of The Tax Court of the United States.

Filed June 19, 1944.

PAUL P. O'BRIEN

Clerk of the United States Circuit Court of Appeals  
for the Ninth Circuit.